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Ideas on Liberty

MARCH 1975

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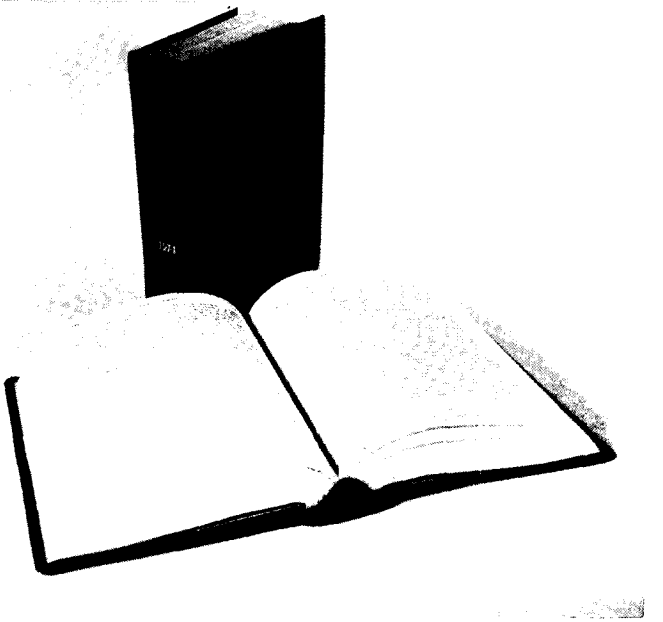

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How Inflation Breeds Recession

HENRY HAZLITT

BOTH general economic and purely monetary theory are supposed to have made immense advances since the middle of the eighteenth century, yet the confusion and chaos in economic and monetary theory have never been greater than they are today. One would think, listening to television and reading the newspapers and magazines, that inflation – in the popular sense of soaring prices – were some infinitely complicated, mysterious and incurable affliction that had suddenly struck us from the blue, instead of simply what it is – the inevitable consequence of the actions of government in overspending and then printing paper money.

And as the cause is obvious and simple, so is the fundamental cure. The direct cause of soaring prices is printing too much paper money; the direct cure is to stop printing it. The indirect cause of inflation is government overspending and unbalancing the budget; the indirect cure is to stop overspending and to balance the budget.

But if the cause and cure of inflation are so fundamentally simple, why is there so much befuddlement? One reason, of course, is that the problem is not merely economic, but political. The problem is not merely, for example, to get the politicians to recognize the true cause and cure of inflation. It is also to get them to *acknowledge* that cause and *adopt* that cure. In brief, one reason so many politicians do not understand the problem is not merely that they are too stupid to understand it, but that they do not want to understand it.

They realize that inflation is a

Mr. Hazlitt, noted economist, journalist and author, adds what might well be another chapter to one of his books: *What You Should Know About Inflation.*

This article is based on a paper delivered January 6, 1975, at a monetary conference in Miami.

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political racket. They find that the way to get into office is to advocate inflation, and the way to stay in is to practice it. They find that the way to be popular is to appropriate handouts to pressure groups who represent mass votes, and not to raise taxes except those that seem to fall mainly on some unloved or envied minority group – oil companies, corporations generally, the reputedly "rich" or "superrich."

The ultimate result of such policies is to bring about exactly what we have today – inflation *plus* recession.

But we are brought back to the fact that politicians could not exploit the befuddlement of the public about inflation if that befuddlement did not already exist. So though we must not overlook the political side of the problem, we must recognize that our main task is still one of educating the public.

This is a much bigger problem than it is commonly thought to be.

Even when we have explained to people that inflation is caused by excessive issues of paper money, and by budget deficits that lead to excessive issues of paper money, we have done only a small part of our task. We have explained what causes inflation, but we have not explained why inflation is so pernicious. The truth is that the greater part of the public still thinks that inflation is on the whole beneficial. They know that it raises the prices of commodities, but the chief thing they consider bad about this is that it may not raise their wage-rates or salaries to the same extent. Nearly everybody thinks that inflation is necessarily stimulating to business, because they think it must raise profit margins and so lead to greater production and employment.

This is indeed usually true in the first stages of inflation. But what is still recognized only by a tiny minority is that in the later stages of inflation this ceases to be true. In its later stages inflation tends to bring about a disorganization and demoralization of business.

It tends to do this in several ways. First, when an inflation has long gone on at a certain rate, the public expects it to continue at that rate. More and more people's actions and demands are adjusted to that expectation. This affects sellers, buyers, lenders, borrowers, workers, employers. Sellers of raw materials ask more from fabricators, and fabricators are willing to pay more. Lenders ask more from borrowers. They put a "price premium" on top of their normal interest rate to offset the expected decline in purchasing power of the dollars they lend. Work-

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ers insist on higher wages to compensate them not only for present higher prices but against their expectation of still higher prices in the future.

The result is that costs begin to rise at least as fast as final prices. Real profit margins are no longer greater than before the inflation began. In brief, inflation at the old rate has ceased to have any stimulative effect. Only an *increased* rate of inflation, only a rate of inflation *greater* than generally expected, only an *accelerative* rate of inflation, can continue to have a stimulating effect.

But in time even an accelerative rate of inflation is not enough. Expectations, which at first lagged behind the actual rate of inflation, begin to move ahead of it. So costs often rise faster than final prices. Then inflation actually has a depressing effect on business.

A Crucial Oversight

This would be the situation even if all retail prices tended to go up proportionately, and all costs tended to go up proportionately. But this never happens — a crucial fact that is systematically concealed from those economists who chronically fix their attention on index numbers or similar averages. These economists do see that the average of wholesale prices usually rises faster than the average of retail consumer prices, and that the average of wage-rates also usually rises faster than the average of consumer prices. But what they do not notice until too late is that market prices and costs are all rising unevenly, discordantly, and even disruptively. Price and cost relationships become increasingly discoordinated. In an increasing number of industries profit margins are being wiped out, sales are declining, losses are setting in, and huge layoffs are taking place. Unemployment in one line is beginning to force unemployment in others.

All this is the consequence of an inflation in its later stages. But the irony is that this consequence is systematically misinterpreted. The real trouble, everybody begins to think, is that there is not *enough* inflation; it must by all means be speeded up.

This is the stage at which we have now arrived. A swelling chorus of voices has been demanding that the Federal Reserve "temporarily," at least, increase the growth rate of the money supply. It is almost universally believed that the reason the banks' prime lending rate was recently at 12 per cent is that the Federal Reserve was following a "tight money" policy. The Federal Reserve authorities even themselves

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seem to believe this. In early December they reduced the discount rate from 8 to 7¾ per cent, and a month later to 7¼ per cent, to prove that they meant to follow a less stringent money policy.

The truth is that market money-rates have been high precisely because we have been inflating, precisely because the Federal Reserve has for too long been following a recklessly loose money policy. As compared with the 8 per cent discount rate of the Fed, the discount rate of the Bank of England was last year between 11½ and 12½ per cent, the discount rate of the Bank of Brazil 18 per cent, the discount rate of the Bank of Chile 75 per cent.

Discounting Inflation

None of these rates was a result of a tight money policy in the countries concerned. Quite the contrary. The greater the past or present rate of inflation, the higher the present prevailing interest rate. This is because, in the later stages of an inflation, people expect the recent rate of inflation to continue. If they believe, for example, that the dollars or pounds or cruzeiros or escudos that they lend today will have a purchasing power of x per cent less when they get them back a year from today, they will add that x per cent to the normal rate of interest they would otherwise have expected. If their expectations are justified, though they will be getting a very high nominal rate of interest, their real rate of interest will not be above normal. But the high nominal rates of interest will none the less tend to discourage borrowing.

Again, as I have already pointed out, labor unions will begin to demand so-called "protective" pay increases sufficient not only to compensate them for the commodity price increases that have taken place since their old contract was signed, but for the price increases that they fear will take place in the future life of their new contract. Union demands will tend to become increasingly unreasonable. The number of strikes will tend to increase. Profit margins will be squeezed or wiped out arbitrarily. Price-and-cost relationships among different industries will become increasingly unsettled, unpredictable and disorganized.

In short, "protective" actions and other compensatory reactions to inflation and expected inflation will often turn inflation in its later stages from a stimulating force to a depressing and demoralizing force. But the public and politicians will increasingly believe that these depression consequences of continued inflation are the consequences of insufficient in-

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flation. They will demand that the inflation be still further accelerated.

The reason an inflation is not stopped is that people begin to dread more and more what will happen if it is stopped. They fear a stabilization crisis. They fear mass unemployment. The only alternative seems to be to accelerate the inflation. But, as we see, this simply leads to increasing disorganization and demoralization of business. In the end, we begin to get mass unemployment anyway.

Suppose, by some miracle, the government stopped inflating — now. Would the consequences really be as bad as most people fear? There is every reason to think that they would be incomparably better than if the demoralizing effects of the inflation are allowed to continue.

German Hyper-Inflation

We can get some light on this if we study what happened in the great German hyper-inflation which ran roughly from 1919 to the end of 1923. In the course of that inflation the German paper mark fell to a purchasing power equal to only *one-trillionth* of what it had been before the inflation set in. This is another way of saying that prices soared a trillionfold.

In the last stages of that inflation production became disorganized and unemployment soared. Industrial production plunged from an index number of about 125 in 1921 to about 60 in 1923. Unemployment among trade union members, which had been as low as 0.6 per cent in July of 1922, rose to 19.1 per cent in October, 1923, to 23.4 per cent in November, and to 28.2 per cent in December. The index of the real income of the German industrial population plunged from a range of 75 to 105 in 1921 (with 1913-14 equal to 100) to a range of only 36 to 47 in November of 1923. These figures are taken from Prof. Frank D. Graham's 1930 book on the German inflation. They show how inflation in its later stages can demoralize production, real income and employment.

Was the stabilization crisis so dreadful when this inflation was finally brought to a halt? I regret that the commonly available figures are not quite adequate to answer this question satisfactorily. Practically all the tables published in the books of both Frank D. Graham and Costantino Brescian-Turroni end at December, 1923. But supplementary evidence indicates that the stabilization crisis was brief and the recovery quick.

The index of the physical volume of industrial production per

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capita, taking 1913 as a basis of 100, had fallen to 54 at the peak of the inflation in 1923. It rose to 77 in 1924, to 90 in 1925, and to 111 in 1927. This was a better comparative record of recovery from 1913 than that of England, Italy, or West Europe generally.

Heavy Unemployment?

C. W. Guillebaud of Cambridge University, in his book *The Economic Recovery of Germany* (1939), tells us that "The cessation of inflation brought with it as its immediate effect a large increase in recorded unemployment, which rose to 1,533,000 on January 1, 1924."

The justification for this statement depends on what date we place on "the cessation of inflation." The monetary reform was introduced by a decree issued on October 15, 1923. The actual introduction of the new currency, the rentenmark, did not come until November 20, 1923. But the Reichsbank kept grinding out paper marks at accelerative and astronomical rates continuously through the end of December.

If we consult the monthly statistical series (not given in any table in Guillebaud's book) from which his January figure was apparently taken, we find that recorded unemployment in October, 1923 was 534,000, in November 955,000, and in December 1,473,000.

So the January figure of 1,533,000 of recorded unemployment was not much above this. In any case this unemployment was shortlived. In spite of interest rates, in terms of the new currency, as high as 100 per cent in January, and even from February to May at an average, figured annually, of 35 per cent, Guillebaud tells us that "activity revived, and unemployment for the first time since August, 1923 began to decline, and was not more than 700,000 in April, 1924." It fell to 328,000 by July, better than a normal average.

Rapid Recovery

A similar picture of recovery is given by Costantino Bresciani-Turroni, in his book *The Economics of Inflation* (1931). This is the most thorough and the most famous of the books written on the great German inflation. Bresciani-Turroni tells us that in the first months of 1924, when the inflation was over, there was "a remarkable increase in wages," and that this "big increase in the average income of workers was the combined effect of the rise in wage-rates and the fall in unemployment" (p. 396). And in the final summary paragraph of the book he writes:

"At first inflation stimulated

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production because of the divergence between the internal and external values of the mark, but later it exercised an increasingly disadvantageous influence, disorganizing and limiting production. It annihilated thrift; it made reform of the national budget impossible for years; it obstructed the solution of the Reparations question; it destroyed incalculable moral and intellectual values. It provoked a serious revolution in social classes, a few people accumulating wealth and forming a class of usurpers of national property, whilst millions of individuals were thrown into poverty. It was a distressing preoccupation and constant torment of unnumerable families; it poisoned the German people by spreading among all classes the spirit of speculation and by diverting them from proper and regular work, and it was the cause of incessant political and moral disturbance. It is indeed easy enough to understand why the record of the sad years 1919-23 always weighs like a nightmare on the German people."

The lesson is clear. We should stop our own inflation now. Not some time in the future, but now. We should not slow down the rate gradually over the years, but stop inflation now. And this means, to repeat, two main measures: first, balance the budget, balance it wholly by slashing expenditures and not at all by raising taxes; and second, stop expanding bank credit and printing paper money.

Some other measures will be necessary to make these two basic steps effective, but I will mention only one of them, because of its overriding importance. We should repeal all the labor laws, passed over the last forty years, that build up the power of labor unions, strengthen the extortionate strike-threat system, and in effect force employers to capitulate to labor union demands. This means the repeal of the Norris-Laguardia Act, of the Wagner-Taft-Hartley Act, of the Davis-Bacon Act, and probably a nest of others.

Inflation

IDEAS ON LIBERTY

THE FATAL ERROR — that the credit and currency of the Continental money could be kept up and supported by acts of compulsion — entered so deep into the mind of Congress and of all departments of administration through the states that no considerations of justice, religion, or policy, or even experience of its utter inefficacy, could eradicate it.

PELATIAH WEBSTER, *"Strictures on Tender Acts" (1780)*

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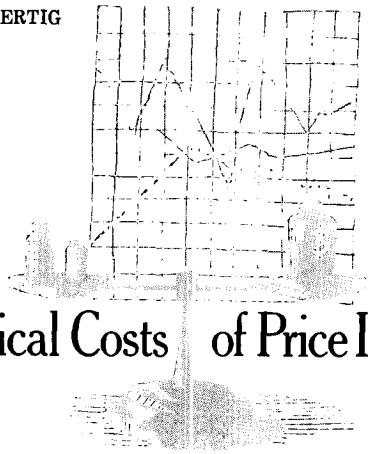
LAWRENCE FERTIG



The Political Costs of Price Inflation

JUST A FEW MONTHS AGO when President Ford took office it was proclaimed from the White House, and nightly on television and in the press, that inflation is our Enemy Number One. But then – in the words of the famous play – a Funny Thing Happened on the Way to the much-publicized Summit meetings. It was discovered by many authorities that inflation is not necessarily Enemy Number One, but might be considered Enemy One-Half, One-Fourth – or perhaps Enemy Zero.

It was said we faced what was called "Stagflation," and it was asserted that we had better fight the "Stag" part and not pay too much attention to the "flation."

Professor Walter Heller, who had viewed with unconcern the substantial monetary inflation of the past many years, asserted some months ago that our present trouble is "the costly stagnation arising out of a short-fall in aggregate demand." Other distinguished professors lent their authority to this diagnosis. Professor James Tobin of Yale declared in an ingenious formulation that "Monetary inflation is not the cause of current rising prices," and he agreed with Dr. Heller that a good prescription was a little more of the hair of the dog that bit you.

Since monetary inflation, which is always and everywhere the basis of price inflation is being

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Mr. Fertig is a noted economist and journalist. This article is extracted by permission from a paper delivered November 14, 1974 at a conference of the Committee for Monetary Research and Education.

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thus minimized, I conclude that some attention might well be paid to assessing the political costs of this dangerous process.

Some people ask, "Why this heavy accent on curbing inflation when it is now plain that we are in the midst of a serious recession?" The answer to that question is two-fold. In the first place this recession and all its symptoms – rising unemployment, falling commodity prices, lower production, and the like – are the *direct* result of the previous roaring inflation and constitute the penalty that must be paid if the dangerous inflation of past years is to be brought under control. This nation has been on a monetary binge, and our financial managers have created a vast ocean of paper money and credit which has had its baneful effect on markets.

The Danger of Hyper-Inflation

The second part of the answer to the above question is most important. We have the power to curb the inflationary process over the period of a year or two at the cost of recession and some national sacrifice. If we do so we will lay the foundation for a much sounder economy – an economy that can produce efficiently and amply. But if we do not take restrictive measures now, then inevitably we will be headed for a roaring *hyper*-inflation. This could well result in price increases five or ten times as great as those we have already suffered. So the choice is either recession and curbing the monetary inflation *now* versus a continuation of our past monetary policy which could result in *hyper*-inflation and national disaster.

It's plain, I believe, that the political, economic and social costs of inflation are all bound up together. It is impossible to disentangle one from the other. They act and re-act upon each other as both cause and effect. For instance, when a government inflates its currency to cover a substantial deficit, and after a time-lag prices zoom upward, the natural result is social unrest. In turn, the frustrations of citizens may cause them to succumb to the blandishments of politicians who offer economic nostrums which result in socialization, a decline in essential capital investment, and a fall in the standard of living.

This is precisely what happened in Britain after Mr. Heath chose to inflate in 1971 in order to achieve "growth" and to meet the money demands of the labor unions. The results of the October 1974 election will surely be a giant step toward a poorer, Socialist Britain. While Wilson has a ma-

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jority of only three seats, he can count on many of the 14 Scottish and Welsh nationalists to vote with him on such crushing legislation as a tax on wealth, increased subsidies, price controls, and perhaps even on the nationalization of some large industries. No, we cannot unscramble the economic, social and political where parliamentary government prevails and every citizen is entitled to cast a ballot in free elections.

However horrible may be the consequences of continued monetary inflation, the penalties to be borne for a continuation of this policy are generally believed to be sometime in the future. Of course the distant future never presents the terrors of the immediate present. So it is generally felt that we can rest on our oars a little. It is rather pleasant, as even Professor Galbraith pointed out, to fight a possible recession by monetary expansion rather than to contain a present inflation by monetary restraint.

Economic Nationalism Ahead

One of the most frightening political costs of continued inflation, which isn't obvious to the general public, is the intolerable strain on our international alliances and the frenzied flight toward economic nationalism. Nations try to offset the detrimental consequences of inflation by import quotas, higher tariffs, subsidies for export, and the like. But it is plain that in a world in which practically every naton is inflating – not *every* nation can have an export surplus. This kind of competition causes acrimonious debates among former friends.

Many people used to glibly assert that devaluation of a nation's currency is a prescription to cure its economic difficulties. Since its exports would be cheaper in world markets after devaluation, such a move, it was said, would redress its balance of payments. In the short run this would perhaps be so, but not in the long run. Imports for such a nation become more expensive. Other nations can play that game too, by devaluating *their* currency. In time, real values of international products tend to re-establish their old relationship, all other things being equal.

Regardless of long-term effects, a nation in trouble because of inflation always seeks to gain a temporary advantage by any possible means. Under such conditions the weakening and eventual break-up of political alliances becomes very probable. At that point, the non-Communist nations of the West are in as grave danger as the weakened traveler in the Arc-

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tic who is no longer able to resist the attack of wolves. If, under these conditions major nations of the West succumb, there would be no return to parliamentary government. If Communist regimes were established in any of the major nations of the West, it would be almost impossible to overthrow them and return to a free society.

It's interesting to note that in another age – from the mid-19th Century to World War I – when nations voluntarily subjected themselves to monetary discipline, when internal adjustments of inflationary and deflationary forces were automatic, the break-up of the Western world was not threatened. Those were the days when nations were guided by the rules of neo-classical economics, when major wars were few and far between, and when nations adjusted themselves *voluntarily* to economic realities.

Defense Endangered

One more point needs to be emphasized in discussing the international repercussions of inflation. The essential defense of the United States becomes endangered since it is politically impossible to cut total Federal expenditures without seriously eroding the defense budget.

While the defense budget becomes an easy target of attack, the very largest, the most overblown department in U.S. government, which spends more than any other, is almost sacrosanct. The Department of Health, Education, and Welfare, with a current budget of $110 billion after severe trimming, still represents a 16 per cent increase over last year. I must note that the subsidy checks which go out from this Department to tens of millions of voters are a powerful political force in causing fear on the part of anyone in political life who wishes to drastically revise this budget.

On the *domestic* effects of ininflation, the incontestable fact is that inflation undermines and corrodes the economic, political and social structure of a nation. Its long-run effects are catastrophic. In the long run it is death to parliamentary government itself.

Consider for a moment the effect of continued inflation upon the political structure of this country. The government of the United States is no more stable than the emotions and ideas of the electorate who ultimately control the legislature and, as Mr. Dooley said, even the Supreme Court. Representative government in time responds to the insistent demands of an outraged public.

What are the reactions of mil-

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lions of people who find themselves frustrated and helpless in the face of rising prices which they cannot control? It is quite natural to opt for any short-term solution which, it is claimed by candidates for high office, will ease their pain. That so-called solution may have nothing whatever to do with the cause of inflation. But it may be plausibly presented and emotionally approved by the electorate.

The basic problem is simply this. Under great stress people tend to approve solutions which seem to provide short-term benefits, but which will in the long run have tragic consequences. They are unwilling, for any length of time, to subject themselves to short-run costs and restraints. When people feel that way, their representatives in government subscribe to current demands and provide short-run panaceas – regardless of long-run effects.

The terrible price we pay for political intervention to achieve short-run effects in an era of inflation is well illustrated by our current policy to meet the energy shortage. The government now sets the price of domestic "old oil" at less than half the true market price. It is estimated this currently saves the consumer about a nickel on a gallon of gasoline. But it also means that, because of the present lower consumer price and the increased consumer demand, we are importing 500,000 barrels a day of higher-priced oil – thus becoming hostage to the Arab world.

Now, in the long run the way to defeat the Arab cartel is to *increase* the American price of oil. This would stimulate more exploration and production, and most important, it would stimulate energy substitutes – gasification of coal, and so forth, which will become profitable to produce only when oil sells at a higher price. So what do we choose – a nickel or a dime now – or American independence of Arabs? There, in a nutshell, is a horrible example of the baneful effect of government intervention during an inflationary period.

2-Party System Undermined

Now this accent on immediate benefits encourages demagoguery. It politically rewards the demagogue who promises most. In effect it tends to undermine the two-party system without which the United States would fall victim even more easily to the demands of minorities and to the chaos which frequently characterizes multi-party government. The reason it undermines the two-party system is because it becomes unprofitable and even politically

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dangerous for a major party to oppose insistent public demand. Such opposition is usually penalized at the polls, no matter how statesmanlike, how right, how wise the opposition may be.

Today we know that even if it is at all possible to curb inflation by a gradual approach over many years, some sacrifice, some restraint, some fortitude on the part of the public is required. Will it be forthcoming over many months and perhaps over several years? That is the question which must be answered before we know whether we can curb inflation. The crucial point is that the problem is a political one and not altogether economic.

During a long period of inflation, when the public is distressed and frustrated, it inevitably looks around for a scapegoat. That uncontrollable desire to "hang somebody for the fix we're in" is aided and abetted not only by demagogic politicians but even by more moderate legislators who shudder at standing in the way of the steam-roller of public opinion.

Now who would you guess would be the most natural scapegoat – the un-person, so to speak, who has few defenders and a host of critics? Why of course it's the Corporation – big business which we know is largely responsible for the fantastic increase in America's standard of living, and which is the income producer for most families.

Muckraking is an old and honored tradition in this country, especially by leading commentators on TV and radio, by columnists, by intellectuals in the academic fraternity, and many others who are important in the formation of public opinion.

No matter how logical the answer made by corporations to these attacks, no matter how tightly reasoned the defense, the opposition poisons public opinion and urges the politicians to penalize profits and capital investment. But it is an elementary fact that increased capital investment and profit opportunities for business are the only possible way for a nation to improve its standard of living. No matter – Naderism will have its day, and the attempt will be made to inflame the public against "excessive profits." The fact that profits were inordinately low for a decade or more (as in the steel industry), or that high profits are necessary to attract capital to a most needed resource such as oil – all this seems to have little bearing upon public opinion during an inflationary period. When economists point to "phantom profits" due to inadequate depreciation and to false inventory profits, the answer of politicians

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and of the public when inflation is rampant is a mere shrug of the shoulders. The stated dollar increase of corporate profits becomes *ipso facto* an indictment of corporations.

Envy Is Encouraged

Not only are corporations adversely affected by the public reaction to inflation, but individuals and groups who are important in their performance of basic economic functions are also subject to attack. During a high level inflation there is naturally a tremendous amount of speculation. Speculators, short-sellers, commodity traders, all perform a function in the market. But they become targets for political attacks to a great extent because they are successful in offsetting the effects of inflation. In fact, any group in society which becomes affluent under an inflation is open to attack.

In any analysis of this phenomenon, I would call attention to a basic psychological fact which is treated in masterly fashion by Professor Helmut Schoeck. His scholarly book, *Envy,* uncovers and reveals the social and political implications of a deeply repressed motive – envy. Professor Schoeck says "Envy is a drive which lies at the core of man's life and social being." Sociologists of modern liberal persuasion refuse to admit this, but it seems to me a very meaningful assumption. During any violent inflation this basic human trait is exacerbated, and expresses itself in oppressive social and political action.

Death of Parliamentary Government

I have catalogued briefly some of the political consequences of continued inflation. But I do not believe that the public generally realizes what a corrosive social and political force it can be. As I pointed out earlier in this discussion, politicians who appeal to the public seem ready to give them every kind of assurance and are often unscrupulous in recommending measures which will not only be unrelated to curbing the inflation but will actually, in the long run, increase it. As it continues over the years, inflation becomes so unmanageable that finally there is one inevitable consequence. It is a distressing fact that under continued high-level inflation parliamentary government and the democratic process will die. The repressive measures essential to curbing hyper-inflation can never be undertaken by freely-elected representatives in parliamentary fashion. It requires a dictator and the power of an army behind him to put into effect those measures which will curb a violent inflation

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over the years. The inevitable consequence is for the public to rely upon the promises of some man on horseback.

This is precisely what happened in Brazil and in Argentina. And this pattern will beyond doubt be repeated in other countries of the world when their inflation gets severe enough and becomes unmanageable. In Brazil inflation reached the proportion of 90 per cent annually, when parliamentary government was eliminated and the Army was called in. A similar set of circumstances prevailed in Argentina. In recent months we have been reading of the threat of military action proposed even in the home of the Mother of Parliaments – Great Britain. The inevitable arrival of dictatorship when inflation is prolonged and severe enough is a distressing fact which we must face, but it is one to which the public has never been adequately educated.

Now, since the penalties of continued inflation can be so tragic and since monetary restraint is at the heart of the solution to this great problem, what hope is there in the United States? There is a glimmer – only a glimmer of hope – in the fact that after January 1st gold can be owned by American citizens. The price of gold will hold up a mirror to the weakness or strength of the dollar. It will, to some extent, act as an automatic restraint on dollar creation. But this is not enough. It is essential that we be permitted to make contracts with each other payable in gold, or in the dollar value of gold. Whether this is permissible now under our present laws is a grave question. But there is no doubt that in a free society contracts made in gold should be just as permissible as contracts made in any other commodity. This – plus the ownership of gold – would act as a brake on the insatiable appetite of government for more and more printed paper money. It would be a most important aid in the fight against inflation.

It is quite easy, of course, to state some of the terrible costs – political, social and economic – of continued inflation. If the public really grasped the tragic nature of inflationary consequences it would respond more readily to the discipline which would curb inflation. But it will never respond until there appears on the scene a political leader who is willing to lay his career on the line and, as the saying goes, "tell it as it is." That leader may never again be elected to high public office, but he will have performed a noble public duty which would in history earn the gratitude of this nation.

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LEONARD E. READ

Cause and effect, means and ends, seed and fruit, cannot be severed; for the effect already blooms in the cause, the end pre-exists in the means, the fruit in the seed. — *Emerson*

THERE IS A REASON for our mess. We are now reaping the bitter harvest of the poisonous seed sowed intermittently during the past. We are experiencing bad effects whose causation can be traced to the employment of wrong means. We suffer the natural consequences of our folly, which proves once again that the universe is rational. To state this in another way, if improper methods *did not* lead to failures, we would really have a problem. As it is, we need only take our heads out of the sand to see clearly that interventionism not only has failed to provide the promised something-for-nothing but has led to all sorts of undesirable consequences.

Heads in the sand! I refer to those who do no more than lament the mess we are in; all they "think" about is whether they can survive it. Though greatly puzzled, they fail to get the message the mess is meant to convey. Indeed, many are just beginning to realize that we are moving toward disaster, even though we have been on a wrong heading for decades.

Why then do I thank God for the mess we're in? Simply because the mess is sending up signals — messages loud and clear — that our past is filled with errors which inexorably produced their evil results. The consequences we suffer now were caused by past mistakes, and we need to know what wrong actions are responsible for these bad effects. The fact is, we are being graced with warnings which, when and if read aright, can lead to our salvation. That's why I thank God!

Bearing in mind that what hap-

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pens has an instruction peculiarly its own and that there is something good in everything bad, let us try to find the lesson. Our past is filled not only with moral but politico-economic errors, and our present likewise. How are we to identify these wrong actions and find the right ones, that is, how expose the fallacies of state interventionism and reveal the merits of human liberty as related to the interest and benefit of every one of us?

When liberty prevails, every individual in the entire population is free to bring *persons* and other scarce resources into complementary and workable combinations. Reflect on our varied talents. If we approach the matter properly, we come to note our own lack of most of the talents known to man. I, for instance, could no more bring musicians and instruments together to form an orchestra than I could bring technicians and tools together to release atomic energy or to deliver the human voice at the speed of light. But look around; there are millions who can and do bring individuals and other resources into association that render a fantastic service of all sorts to King Consumer. And, when liberty prevails so does competition, a constructive force that assures that the efficient servants rise to serve all of us better.

When liberty prevails, there are in the U.S.A. not less than 130,000,000 adults free to release their greatly varied and *unique* creative energies. The aggregate of these energies – the bringing into combination of *things* and *persons* – is beyond the power of anyone to even imagine, let alone measure.

Consequences of Intervention

Let us now observe what happens to these sources of creative energy when the state regulates and controls them. What are the consequences when organized physical force – government –controls our creativity, our varied and unique potentialities? To accurately observe and appraise these consequences is to discover the errors – moral and economic – which account for the mess we are in. And the task is to free ourselves from these malpractices.

Suppose that we have found an outstanding individual who has all the degrees and honors mankind has ever bestowed on anyone. How easy to conclude that we, the ordinary consumers, would fare far better than we do now by our own choices, if only we would yield instead to his "wisdom." Assume next that he is given the power to impose his will only on a single person: You. The power to cast you in his image! Instantly, two

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individuals have become noncreative – you and he!

It is obvious why this dictocratic action would abolish your creativity – you have become but an image of him. But why the "great" one? How does this diminish his creativity? Whatever effort he devotes to lording it over you is effort he cannot exercise creatively. No one can, at one and the same time, be a dictocrat and a practitioner of liberty. *These roles are mutually exclusive.* So, we have here a small-scale model of the mess.

Sixteen Million Dictators

From this model proceed to the prevailing situation in the U.S.A. We have some 100,000 governments – federal, state, and local – and about 16,000,000 on the payrolls. An enormous percentage of these persons – little folks, even as you and I – are not just telling a single person what to do but commanding millions of us as to what to produce, what and with whom to exchange, what our money is worth; they dictate hours of labor, wages, what our children must study; on and on and on, even to seat belts.

Summarized, these 16,000,000, with some notable exceptions – those who are not dictocrats – have not only removed themselves from the nation's 130,000,000 potential entrepreneurs but, far worse, they have frustrated, to a marked extent, the morals and the creativity of the citizenry.

As a result of this governmental intervention, the varied talents and the uniqueness of each citizen are more or less imprisoned. Add to this the dictatorial, coercive powers extended to labor unions on an enormous scale and, on a lesser scale, to farmers, businessmen, educators, welfare agencies and others.[1] This is a sketch of the mess we are in.

To repeat, when liberty prevails, all are free to bring things and people into workable combinations to the betterment of all, the policeman included. But when the police and their subsidized minions regulate and control, a do-as-I-say-or-else action replaces, to a great extent, the *bringing* together actions of free and creative people, and to the detriment of all.

Why the qualifying term, "to a great extent"? Why not a total breakdown? The idea and practice of liberty is not that easily overcome. We are born to be free. Having had many experiences with liberty during the past two

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1 If governments at all levels are taking over 40 per cent of our earned incomes, then perhaps we should recognize that over 40 per cent of us are acting as policemen rather than as productive, creative, peaceful producers of goods and services.

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centuries, citizens will course their way around and through the dictatorial edicts; they'll find loopholes – become schemers, evaders. This ingenuity, though debilitating, explains why the mess is not as bad as it might otherwise be; why we continue to live in spite of the mess; why, despite mass killings, millions lived in Nazi Germany and Communist Russia. A fortuitous leakage of creative human energy! As Lord Macaulay observed in 1839:

> It has often been found that profuse expenditures, heavy taxation, absurd commercial restrictions, corrupt tribunals, disastrous wars, seditions, persecutions, conflagrations, inundations, have not been able to destroy capital so fast as the exertions of private citizens have been able to create it.[2]

The signals are loud and clear – far too numerous to recount. The messages are that every one of these evils we now experience are but consequences of past and present errors. As Emerson so wisely pointed out, "Cause and effect cannot be severed." We must work on the causes rather than the effects if we would repair our ways!

Let me conclude by calling attention to but one signal, a warning that is fretting millions of concerned people all over the world: the rapid decline in the purchasing power of the dollar. The cause? Inflation! Its causes? Excessive governmental expenditures which in turn are caused by people from all walks of life running to government for every conceivable kind of succor – people feathering their own nests at the expense of others. The remedy? Remove the causes.[3]

In any event, I thank God for the mess we're in and its timely warning that we must change our course to avert disaster.

2 See Chapter III in Macaulay's *The History of England* (New York: E. P. Dutton, 1934), p. 217.

3 If interested in a more detailed explanation, see my "How To Stop Inflation," *The Freeman*, November 1973.

IDEAS ON LIBERTY

Adam Smith

THE NATURAL EFFORT of every individual to better his own condition is so powerful that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often incumbers its operations.

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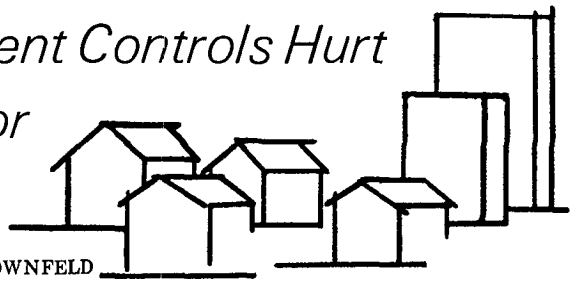
How Rent Controls Hurt the Poor



ALLAN C. BROWNFELD

IT IS AN UNFORTUNATE FACT of life that government involvement in the economy is always initiated in "the public interest," and always ends up helping not the "public," but some smaller private concern.

Through the Civil Aeronautics Board, government was going to regulate the airlines in behalf of the American people. The result has been "regulation" against the public interest. Not one new airline has been permitted by the government to engage in interstate commerce since the CAB was created. Air fares in interstate commerce – controlled by the CAB – are far higher than air fares within a given state, not controlled by the CAB. It is clear that the regulators regulate not in behalf of the public but in behalf of the airlines.

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A similar story is now unfolding with regard to government imposed rent controls in a variety of cities and states. The stated reason for the imposition of rent controls is to protect the poor from exorbitant rent increases by allegedly "greedy" landlords. The result – unexpected by those who have initiated such programs but viewed as almost inevitable by those who understand the dangers of government attempts at economic manipulation – is that the poor are finding it difficult to locate a place to live. The rental market is shrinking dramatically, and men and women are being forced out of the homes in which they have lived for many years.

A recent front page article in *The New York Times* (September 28, 1974) discussed the case of Kathleen M. Jackson, a retired college professor who had lived in

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a quiet old building on Connecticut Avenue in Washington, D.C. for 14 years. Suddenly she was given the option of buying her apartment or moving out. Her new landlords, citing a backbreaking interest rate, an expensive renovation program, and a belief that residential properties are no longer attractive investments, had announced plans to convert their units into condominiums.

Miss Jackson never seriously considered buying her apartment. The price would have been $40,000, which involved a $2,000 down payment and, if she could get a loan, mortgage payments, taxes, and operating expenses of $422.50 a month. The rent had previously been $155. Where she will live in the future is not yet clear. That her situation is becoming commonplace in our large cities is much clearer.

By last June 30, according to estimates of the Metropolitan Washington Council of Governments, 20,618 apartments in the area had been converted from rental to condominium units. There were 572 conversions in 1971, 3,563 in 1972, 8,439 in 1973, and 4,923 in the first half of 1974. New construction, meanwhile, has produced more than 24,000 additional units.

In 1970, 87 per cent of the area's new multifamily housing was rental and 12 per cent was condominium; this year the figures are reversed: 86 per cent is condominium and 13 per cent is rental.

Restricting the Supply

The Wall Street Journal of October 4, 1974 declared that, "In many areas, the conversion of existing apartments to condominiums has . . . constricted the supply of units available for rental." In its Fall, 1974 survey of 20 major markets, Advance Mortgage Corporation, a large mortgage banking concern and subsidiary of Citicorp, found that the apartment vacancies in the majority of these areas were continuing to vanish. The Houston market, for example, was one of the softest in the nation in 1973 with about 17 per cent of its units vacant. By late in 1974 the vacancy rate was 9 per cent and falling "at a rate of one per cent a month," according to Philip L. Hendershot, a vice president of Advance Mortgage.

The effect of this state of affairs may be more serious than many imagine at this time. "People will have to be doubling up, living more with relatives," says Robert Sheehan, director of economics for the National Association of Home Builders. The fastest formation of households will be by

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people in the 30-44 year old age group, reflecting the "baby boom" after World War II. Mr. Sheehan predicts that this group will increase its rate of forming households to about 650,000 annually by 1980 from approximately 225,000 a year at present.

Less Rental Housing

Predictions have it that within 20 years half of the nation's population will live in condominiums – a prediction which implies a shift in housing patterns so vast as to require wholesale conversions throughout the country. David Clurman, an Assistant Attorney General in New York and a leading condominium authority, states that, "I think the time will come when most of the soundly built, well-situated buildings in the United States will be converted." (*New York Times*, September 28, 1974.)

The reason for the destruction of the rental housing market – a market of importance to the nation's poorer families – is clearly government economic intervention. *U.S. News and World Report* declared in its June 24, 1974 issue that condominiums were replacing rental housing because "Landlords fed up with tenant complaints and with rent control or the threat of control often find conversion . . . an attractive way out."

Today, more and more, investors regard the risks of rental property as no longer acceptable. Taxes, utility bills and labor costs are soaring, they complain, while rent controls either hold down income or threaten to do so.

In New York City, which has long had rent controls, the plight of the poor in seeking housing is probably the worst in the nation. The rental vacancy rate is below 1 per cent and private building is at a near paralysis. Richard Stone, writing in *The Wall Street Journal* in 1971, notes that, "Increasing numbers of landlords simply give up, abandoning buildings they can neither afford to maintain nor sell at any price. Tenants, left with no heat, water or electricity, vacate such buildings in a matter of days. When that happens, blight swallows up whole neighborhoods, almost overnight. Every day there are fewer housing units available in New York City than the day before. New York's archaic rent-control law keeps the marginally poor whose fortune is improving from moving out of slum neighborhoods."

Economically Irrational

In his important book, *A Humane Economy*, Wilhelm Röpke points to rent control as an example of an "economic policy" which tends to be "irrational, that is, de-

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termined by what is 'politically feasible' rather than by what is economically rational and just."

He calls rent controls "irrational, ill-considered and at the same time unsocial and inequitable." Röpke notes that, "Rent control is really nothing but the protection of one privileged special kind of tenants, those with old leases, at the expense of the landlords and later tenants alike. Yet it persists, and the explanation is no doubt that, on the one hand, it does need a little reflection and intelligence to see its full implications and that, on the other hand, politicians are afraid to denounce this object of cheap demagogy."

The entire philosophy of coercive government controls on rent may satisfy the statist predilections of some politicians and economists, but surely adds to the burden of the poor – those they were meant to help.

"Rent ceilings," declares economist Milton Friedman, "cause haphazard and arbitrary allocation of space, inefficient use of space, retardation of new construction. The legal ceilings on rents are the reason there are so few places for rent. Because of the excess of demand over supply, rental property is now rationed [in New York] by various forms of chance or favoritism. As long as the shortage created by rent ceilings remains, there will be a clamor for continued rent controls. This is perhaps the strongest indictment of ceilings on rent. They, and the acompanying shortage of dwellings to rent, perpetuate themselves, and the progeny is even less attractive than the parents." (*Newsweek*, March 22, 1971.)

Those who are really concerned about proper housing for the poor should seek to stimulate private investment in rental housing, not retard it.

Rent controls do the poor – and all of us – significant harm. It is one more example of the manner in which government intervention in the economy hurts the very people in whose name such intervention was initially undertaken. When the politicians finally learn this lesson, some hope for an improvement in the housing market will become possible – but not until then.

IDEAS ON LIBERTY

What Rent Control Does

A FINAL IRONY of rent control is that the more unrealistic, Draconian, and unjust it is, the more fervid the political arguments for its continuance.

HENRY HAZLITT, *Economics in One Lesson*

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Nationalize the Power Companies?

ARCH BOOTH

IT'S NO NEWS to most people that the nation's electric utilities are having big problems. The price of imported oil has soared, natural gas is running low, high-sulfur coal can't be burned, low-sulfur coal can't be mined, and the coal that is available is getting more expensive fast. Added to all of the above, the nuclear power plants that were supposed to be helping out by now are far behind schedule.

For all of these reasons, the cost of electricity has been going up steeply – and the tempers of consumers have been keeping pace.

The utilities have not caused the bad news, but it is their misfortune to be the bearer of it – in the form of their monthly bills. And some people are reacting much as did those ancient rulers who were inclined to behead a messenger bringing bad news.

Predictably, demagogic politicians have seen in this situation an opportunity to enlarge their empires. Cries are being heard for government takeovers of the electric utilities.

The presumption, of course, is that the government could do a more efficient job of providing power than the private companies.

But could it? The country's largest electric power system is a Federal agency – the Tennessee Valley

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Authority. So, before we start nationalizing the private electric industry, it might be advisable to take a look at TVA.

First, TVA priced its electricity low and encouraged all-electric homes – a practice that environmentalists consider a waste of resources when a private company does it. Consequently, TVA serves more all-electric homes than any other electric utility.

Second, TVA let its vital coal reserves get dangerously low while it waited for the price to come down. The price went up. Now the agency is frantically scrambling to scrape up enough to see it through the winter. And it doesn't look as if it'll make it.

TVA has already asked its biggest single customer – The Atomic Energy Commission – to accept a 50 per cent power cut. It was an offer the AEC couldn't refuse.

TVA also appealed to its other customers to reduce power use by at least 20 per cent. The result was a five per cent reduction.

Now, TVA is talking about a mandatory five per cent power reduction. If that isn't enough, the next step will be to cut off business and industrial users. After that will come "rotating brownouts," during which one-third of an area's power will be cut on a rotating basis.

Clearly, government-run utilities are not immune either to management mistakes or to the effects of price increases in the fuel market. Of course, the government *does* have the ability to use tax revenue to paper over the gap between income and outgo. But that doesn't really save the consumer money – it just takes it out of another pocket. And, government subsidies disguise the true cost of a product, which invariably leads to wasteful and inefficient use of scarce resources.

Nationalize the power companies? Well, let's put it this way: Would you want your electricity to be delivered by the U.S. Postal Service?

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The Progression of Profitability

JOAN WILKE

A MAN STARTS with an idea and a few years later, untold millions have profited from it in many ways – ways they've never even thought about.

Profit multiplies and spreads contagiously to everyone. You can't help but "catch it" – even if you're hundreds of miles away – or hundreds of years.

When one man profits, virtually everyone profits, and the spreading circles keep expanding, interacting and overlapping – all ways and always.

The consumer benefits directly from the service or product he buys or he wouldn't buy it. By purchasing from the most efficient (profitable) producer he profits by making his money do more and go farther.

Workers, distributors, suppliers and all secondary services such as transportation, utilities and so on profit from helping to provide the product.

The wage earner's new profitability enhances his marketability so that he enjoys raises, profit sharing, vacation, insurance, pensions and other forms of remuneration.

All kinds of merchants and community services profit from the profits in all these other pockets in the form of wages, dividends, fees and the like – which in turn becomes wages.

And the profitable product of one company is often a profitable tool in the operation of another. How many businesses depend on the telephone and typewriter? And for want of a nail, how many businesses would be lost or not have materialized? And the winged nut? And the staple? And plastic? And everything we take for granted? Once inventions themselves, these things are now relatively cost-free factors of production. Many are cost-*saving* factors of production, replacing less efficient methods and materials.

So the profit of one company

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augments the profit of others and the efficiency is passed on to consumers in lower prices as well as paying more wages, dividends, interest – with all their corresponding reverberations through the economy.

Although the economy is called "competitive" and it is, it could more rightly be called a system of mutual profit. The nature of competition prevents any standing still or retrogression. Under competition, the initial profit margin diminishes. As soon as the idea is exposed *and is profitable,* others compete to try to produce it better or at lower cost. The original company must either continually improve its product or service to maintain leadership, lower the price or abandon the now unprofitable item and produce something else that's more beneficial to society, which is to say more profitable.

Only favors of governmental partisanship can disrupt this spiral of progression, improvement and profitability.

Profit is the *incentive* toward activity, the *reward* for the activity and the *means* of accomplishing activity. The more an entrepreneur profits the more he is able to accomplish, and his scale of profitable activity expands rapidly.

One man starts out as a carpenter, builds a few houses and finds it so profitable he develops new mass-production techniques in construction to build faster and goes on to build whole communities of low cost homes. And this is *real* low cost housing, not high cost construction offered at low prices with the difference paid by the taxpayer.

A retired southern gentleman takes a family recipe and in a few years builds a multi-million dollar franchise operation creating business opportunities for countless people, employing thousands and serving millions of low cost chicken dinners to budget conscious families. And this is *really* low cost food, not high cost food sold at low prices with the difference paid by the taxpayer.

A penniless young cartoonist draws an entertaining mouse whose profits allow his genius to explode into myriad areas of modern technology, engineering, entertainment innovation, film techniques, scientific inquiry and community development. He is a true benefactor of mankind, his progress and vast accomplishments paid for by his past successes.

It should be apparent that a tax on profit is a tax on the future – an impediment to progress – a production-stopping, idea-blocking, paralyzing obstruction to the advancement of everyone.

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A product is simply an idea that has materialized out of profit—one's own profit from previous success or the invested profit of others who see additional opportunity for profit.

Only a profit economy can offer "something for nothing." And that "something" is in virtually everything produced competitively. It's often the competitive edge. It is sometimes a premium or giveaway item. While it can be argued that the cost of the premium is in the price of the product, it is also true that the product still must be sold at a competitive price or with a premium so appealing that new value is created. Economically, that's as close to something for nothing as it's possible to get.

Another of the universally profitable aspects of an open, competitive economy is that unprofitable activity diminishes, fails and dies out. The pruning of wasteful activity is as necessary to the profitability of an economy and society as the profit of the successful ventures.

Besides, failure is experience gained, the storehouse of future success. And the "losers" still reap all the benefits of the other efficiencies in the profit economy. The overall efficiency bolsters everyone.

A competitive, profit economy cannot be described accurately as the survival of the fittest. On the contrary, it is a matter of strengthening the weakest . . . enriching the poorest . . . upgrading the whole.

We all have a vested interest in each other's profit because it always represents efficiency. Every efficiency is gained by all. Every waste is suffered by all.

The currently popular term "excessive profits" is a madcap absurdity in an open, competitive market. No profit is too great when it represents efficiency and when it is the potential of the future. The efficient producers are precisely the people society should want to profit the most so it can benefit from their activities in other ways. Applying the word "greed" to profit is another malapropism. It is far more appropriate in describing the welfarists' drive toward expropriating the profits of others.

All government controls—wages, prices, tariffs, subsidies and the rest—are all forms of *profit control*. As such, they are curbs on efficiency. Since every product is a service of some kind, what is taxed is the ability to provide a service. And it is deducted from future efficiency in producing the service. What is being deducted from society in a cumulative and accelerating way, is efficiency itself.

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Tax is paid on what a company has. It is deducted from what it could be. It is paid on what it has produced. It is deducted from what it could produce.

When people tax a company in a competitive economy, they are taxing themselves – everyone – in many ways. Not just in adding to the cost of the product. Not just in dollars. In jobs . . . in efficiency . . . in initiative . . . in opportunities . . . in convenience, comfort, fun . . . a myriad of inconceivable, unpredictable things. They are being taxed in ideas.

When we tax profitable companies and subsidize unprofitable ones, we are paying for square wheels with money that could be buying not only round wheels, but as yet undeveloped methods of travel. In a controlled economy, we're all losers. We can't even be aware of all we've lost.

We're not taxed in dollars, we're taxed in things that might have been. The dollars paid in taxes in 1940 would have bought clotheslines, wringer washers, block ice for the ice box, and radios. The dollars paid in taxes today will buy color television, micro-wave ovens, telephone answerers and video tape casettes.

If our economy were completely controlled, we'd still be paying our taxes in clothesline money. If our economy were completely free, there's no telling what still undeveloped marvels you could have in your home for the dollars you're paying in taxes.

The dollars are nothing – it's the things we're losing. If the man who invented the wheel lived under the system of distribution we are giving way to, everyone would be sitting around looking at his spoke and no one would have a car.

It's profit that makes the world go 'round – and if that isn't love, it's at least enough appreciation of others to allow them to profit, and in so doing, to profit oneself.

A profit economy is nothing more than an open entry, private contract economy with no licensing, permits, trade barriers, subsidies or other governmental restraints, privileges or controls. Its basis must include the realization that one's own progress materially, intellectually and in many ways, is advanced by the progress of others.

"BUSINESS MUST MAKE A PROFIT"

PAUL L. POIROT

IT'S A VERY NICE THING to be a businessman who earns a profit through his efficiency in using scarce resources to serve customers. Nice, because profit, in the

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strict economic sense, is something for which consumers pay without its costing them anything. Profit accrues to the efficient producer who manages to cut costs; it is taken out of costs, not something added to the price. Prices in a free market, with freely competing buyers and sellers, are determined by supply and demand. And a given market price may afford one or more sellers a handsome profit while other sellers may be taking a loss. It depends on the efficiency of the seller as to whether he makes a profit; it doesn't cost the buyer anything.

So much for the economics of profit. But that isn't the point of this story. The point is that in today's mail were two laments that "business must make a profit" – from entirely opposite views.

One was a businessman's contention that he was entitled to a fair profit in order to acquire the capital to stay in business – so he could continue to pay high taxes, among other things. True, he's entitled to all the profit the market price will afford him, which means that he will have been more efficient than some of his competitors in that field. If consumers are not willing to pay a price that yields a given supplier a profit, then he's free to cut his costs or go out of business or whatever; but he's not entitled to a profit unless he earns it in open competition. And if he earns a profit, it's no one else's business whether he uses it to increase his capital investment, or to pay his taxes, or to support his church, or to keep up with the Joneses.

The other lament that "business must make a profit" came from a misguided socialist who seemed to think that meant "the government could do it cheaper." He couldn't know, of course, unless his so-called government exercised no powers of coercion and behaved as just another competitor in the market. In that case, assuming a strong market demand, any supplier who could "do it cheaper" would thereby earn a profit. So what really perturbs the social planner is that businessmen will not attempt to do things that are unprofitable. In that case, if it's going to be done at all, the government will have to force someone to do it – which only seems to be cheaper than paying free market prices for the scarce resources used in the process. Another word, more descriptive of that governmental process, is w-a-s-t-e – just plain waste!

And that's the story. Profit is a fine and honorable reward for efficient service – and no wicked and slothful servant is entitled to it.

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NO NEW URBAN JERUSALEM

BENJAMIN A. ROGGE

IN THE PARAGRAPHS to follow you will find me critical of most of the work now being done on the nature of the urban crisis and equally critical of the public policies proposed to ease that crisis. To compound my sin, I offer no alternative scheme by which the New Jerusalem can be erected on the shores of the Hudson or Lake Michigan or Lake Erie. I intend to argue that no one even knows how to *define* the New Urban Jerusalem, let alone *construct* it.

In all of this, I will be utilizing no special knowledge of urban processes but rather the simplest of analytical and evaluational concepts of economics. In so doing I am acting upon my firm belief that a handful of hypotheses about human action are sufficient for most, if not all, decisions on economic policy. I would be prepared to argue that the practice of breaking up this useful discipline into agricultural economics, transportation economics, development economics, labor economics, urban economics, and the like, has been productive of much mischief.

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Behind the shield of special circumstances and special knowledge, theories have been developed and given wide acceptance that would be regarded as patently absurd if they were put as a general model; policies have been developed and urged upon society that would be recognizably catastrophic if applied generally.

One Man's Atlantis

Proposition No. 1: The first of the propositions on which I wish to base my argument is the fundamental proposition of all modern value theory: Value does not consist of objectively definable characteristics of a good or service; value exists only as subjective judgment in the mind of each beholder. It cannot be measured directly but only indirectly by the behavior it elicits. There is no way that the subjective valuations of two people can be summed or even directly compared.

Thus, the value of a chair is not something inherently residing in the physical properties of the chair or in its costs of production; its value is different to each viewer and for any one man can be measured only by what other goods or services he would be willing to give up to acquire this particular chair.

There is no way of defining in absolute and universal terms the essential characteristics of the Good Chair; one man's throne is another's torture device. What is true of a chair must be true equally of a city. There is no way of defining in general terms the essential characteristics of the Good City; one man's Atlantis is another's Hell. Nor are there other objective ways of measuring the degree of goodness of a city. For example it is sometimes argued that a good city is one that survives or one that grows. But as circumstances change, the functions served by a city change, perhaps even disappear. Were some of the ancient cities of history and legend less successful because they no longer exist?

Some illustrations: From the introduction to a recent book with the title *Environment for Man: The Next Fifty Years,* sponsored by the American Institute of Planners:

> If we had the technology and the economy – both said to be imminent – to build an ideal environment, what kind would we build? What could environment contribute to a "good" day? Do we know how to define and work toward "Optimum Environment with Man as the Measure"? To date neither optimum nor environment has been defined, nor have we made an adequate beginning at measuring man. *And we must somehow learn to allow for subjective human values.*[1]

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Here we find repeated the ancient myth of planning, that it is possible to both plan the allocation of resources from the center and also to serve the subjective preference systems of the individuals who make up the society. It is doubtful if the planners are capable of designing programs and processes (even with unlimited funds at their disposal) that will in fact produce the outcomes that they, the planners, desire – to say nothing of the outcomes desired by the other members of the society.

A second illustration: In another recent book with the title, *Sick Cities: Psychology and Pathology*, we find the following:

> The *Saturday Evening Post* in an editorial in 1961 called sprawl "perhaps our cruelest misuse of land since our soil mining days. Urban sprawl," it went on to state, "is not the growth of cities. Instead, the cities are disintegrating and spreading the pieces over miles and miles of countryside." Robert Moses, responsible for so many of Gotham's public achievements in the present century, takes the opposite point of view in an article in the *Atlantic Monthly:* "The prosperous suburbanite," he says, "is as proud of his ranch home as the owner of the most gracious villa of Tuscany. The little identical suburban boxes of average people, which differ only in color and planting, represent a measure of success unheard of by hundreds of millions on other continents."[2]

Quick about it: Is "urban sprawl" a vice or a virtue? Well, that all depends. On the basis of my admittedly incomplete reading of the materials in this field, I would conclude that urban sprawl (and all similarly achieved outcomes) are *per se* unacceptable to those who see *any* unplanned outcome as less than optimal. In other words, any characteristic of the urban environment that, like Topsy, "just grew" stands condemned by its very origins.

One final illustration of my thesis, this one drawn from one of the most instructive and civilized books yet written on this topic: *The Death and Life of Great American Cities*, by Jane Jacobs.

> People gathered in concentrations of big-city size and density can be felt to be an automatic – if necessary – evil. This is a common assumption: that human beings are charming in small numbers and noxious in large numbers. Given this point of view, it follows that concentrations of people should be physically minimized in every way: by thinning down the numbers themselves insofar as this is possible, and beyond that by aiming at illusions of suburban lawns and small-town placidity. It follows that the exuberant variety inherent in great numbers of people, tightly

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concentrated, should be played down, hidden, hammered into a semblance of the thinner, more tractable variety or the outright homogeneity often represented in thinner populations.

On the other hand, people gathered in concentrations of city size and density can be considered a positive good, in the faith that they are desirable because they are the source of immense vitality, and because they do represent, in small geographic compass, a great and exuberant richness of differences and possibilities, many of these differences unique and unpredictable and all the more valuable because they are. Given this point of view, it follows that the presence of great numbers of people gathered together in cities should not only be frankly accepted as a physical fact. It follows that they should also be enjoyed as an asset and their presence celebrated.[3]

Quick about it: Is high population density a vice or a virtue? Well, that all depends. As that great, mythical Irish bartender, Mr. Dooley, once put it: "As the Frenchman said, as he drank from the fire extinguisher, 'Each to his own taste.' "

To sum up: Given the fact that value is subjective by its very nature, given the fact of the enormous internal diversity of human populations, and given the never ending changes in tastes and circumstances, it is impossible *per se* for there to be constructed a universally valid, objective definition or description of the Good City. City planning is by definition, then, an exercise in either futility or coercion (or both).

It *is* possible for a group of people of like values to agree upon a definition of the Good City and to attempt to implement that particular vision with their own monies and without coercion, and to this I offer no objection. But most True Prophets prefer to work with other people's money, obtained by the exertions of the tax collector, and with the sheriff at their side to deal appropriately with those recalcitrant few who stand in the way of the developing New Jerusalem.

Right Rules Promote Right Outcomes

Proposition No. 2: The Good City will be whatever arrangement of things and people emerges out of the decisions of those people when such decisions are made within a framework of appropriate rules. That is to say, *the Good City cannot be defined in terms of its own characteristics but only in terms of the correctness or incorrectness of the decision-system within which it emerges. Right rules promote right outcomes; wrong rules promote wrong outcomes.*

The point that I'm attempting

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to make here is one I believe to be of greatest significance to this and to all other discussions of social policy-making. I need hardly admit that it is not an idea of my creating but one that many of my betters have developed before me. The best explicit development of this idea, in my opinion, is to be found in the article, "Individualism: True and False," by F. A. Hayek.

> . . . by tracing the combined effects of individual actions, we discover that many of the institutions on which human achievements rest have arisen and are functioning without a designing and directing mind; that, as Adam Ferguson expressed it, "nations stumble upon establishments, which are indeed the result of human action but not the result of human design,"[4] and that the spontaneous collaboration of free men often creates things which are greater than their individual minds can ever fully comprehend.[5]

In this and other writings, Hayek points out that this thesis does not imply that good results will flow spontaneously from individual decision-making under any and all institutional frameworks. On the contrary, Hayek and his predecessors have all stressed the necessity of right rules. Here, for example, again from Hayek:

> True Individualism is, of course, not anarchism, which is but another product of the rationalistic pseudo-individualism to which it is opposed. It does not deny the necessity of coercive power but wishes to limit it – to limit it to those fields where it is indispensable to prevent coercion by others and in order to reduce the total of coercion to a minimum.
>
> The most general principle on which an individualist system is based is that it uses the universal acceptance of general principles as the means to create order in social affairs.

He concludes with a sentence that is the stage-setting for the rest of this paper.

> But if our main conclusion is that an individualist order must rest on the enforcement of abstract principles rather than on the enforcement of specific orders, this still leaves open the question of the *kind* of general rules which we want.[6]

Our search, then, is for the right kind of rules, within whose framework the spontaneous forces of social development would work to produce the better city. It is my argument that these rules, in their general form, are not to be found by assigning a team of urban affairs experts to the task but rather by identifying those *general* rules of human conduct that are morally correct and economically

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efficient. *Note:* Unless the world is totally absurd, that which is correct in principle will also be that which works. It follows from this that those who come closest to understanding and discovering the right principles of human conduct (by whatever means, including, if you wish, revelation) will also come closest to understanding that which will work.

The few simple principles from which I will work from here on out are the ones that make moral sense to me. I need hardly direct your attention to my obvious fallibility and hence to the strong possibility — nay, certainty — that I am wrong in one or more or all of my presuppositions. I go through this exercise as an illustration of what seems to me to be correct procedure — even if the specific principles (and hence answers) are not themselves the correct ones. I remind you that, in my opinion, the correct procedure is one in which, whatever the topic, we reason from first principles to specific policy positions.[7]

You will note that, in doing this, I am careful *not* to attempt to predict the specific details or even the general nature of the outcomes (in terms of urban characteristics) that might flow from the application of the suggested rules to this problem area. The reason, as Hayek has made clear, is that it is impossible to predict the nature of the outcomes of free and peaceful decision-making. Just literally, no one knows what our cities would have looked like had they developed under different rule systems than have in fact prevailed.

What it is possible to do, though, is to relate many of those characteristics of urban life that many see as undesirable to those rule systems that have prevailed — and this I intend to do. This implies that I know what rules would have been morally correct and economically efficient. With a reminder of the caveat issued earlier, I present below a list of some parts of what I consider to be the proper rules system for the dealings of men, one with another, whether those men live in a wilderness or at Broadway and 42nd Street.

- 1. Individuals and groups shall be permitted (have the right) to enter into voluntary exchanges of goods and services on terms of their own choosing, provided that neither force nor fraud is involved.
- 2. Individuals and groups shall be permitted (have the right) to use properties legally under their control in any manner they choose, provided that in so doing no damage is inflicted upon the person and/or property of unwilling third parties.

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• 3. The coercive power of government shall not be permitted (has no right) to be used for any purpose other than that of minimizing coercion in human affairs, i.e. for any purpose other than that generally described in the phrase, "law and order."

• 4. The price to be charged for any good or service shall be that which emerges from the voluntary exchange process.

I am not insisting that this is a complete listing of the appropriate rules. I wish to deal with a manageable number of rules and cases as an illustration of the procedure I believe to be proper, and I do not presume to be presenting a complete, definitive statement of the case.

What I now intend to do is to take each of these four rules and to provide illustrations of specific urban problems that seem to have been brought on or to have been exacerbated by the fact that the rule involved has not been in force.

Rule No. 1: Freedom of Exchange

Case No. 1: I intend to argue here that coercive intervention in labor contracts by government and by labor organizations granted special privileges by government has been an important cause of one of the most dramatic and difficult of the urban problems: the high rate of unemployment among low productivity work groups in urban areas – the young, the old, minority race members, and so forth.

Let us begin with minimum wage laws. For the purposes of a book on which I have been working for some time, I have had occasion to examine what I believe to be every major study ever made of the employment effects of minimum wage setting. Most such studies show in one degree or another a significant direct relationship between upward changes in legislated wage minima and increases in the rate of unemployment in low productivity work groups (with a particularly severe impact on young people from minority race groups).

One of the most informed men in this field, Professor Yale Brozen of the University of Chicago, has written as follows:

> It is hardly surprising that unemployment among the unskilled increased with this rapid rise in the minimum wage. To the extent that teenagers are inexperienced, unskilled workers, they are the ones who have been priced out of the labor market by the rise in the minimum wage rate.[8]

That this interpretation of the evidence is not restricted to those identified as conservative economists is attested to by the fact that the Swedish socialist econ-

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omist and sociologist, Gunnar Myrdal, reports the same kind of finding in his well-known study of American race problems, *An American Dilemma,* where he notes that Negroes have been the main sufferers from the employment effects of minimum wage laws.[9]

The distinguished modern liberal economist, Paul Samuelson, asks, "What good does it do a Negro youth to know that an employer must pay him $1.60 per hour, if the fact that he must be paid that amount is what keeps him from getting a job?"[10]

To the problems caused by the minimum wage laws must be added those caused by child labor laws. Senator Abraham Ribicoff has noted that most of the things he did to earn money as a boy would now be forbidden. His conclusion: this country has far too many laws coddling children.[11] Indeed, as many have noted, the great problem of the urban young person is not overwork but a deadening, self-destroying idleness.

Case No. 2: Another one of the critical problems of American cities is the fact that the proportion of blacks in the inner city is increasing dramatically and these blacks do not have ready access to high income employment and particularly to positions in the skilled trades. This too is a topic to be covered in the proposed Rogge book and, in a continuing show of immodesty, I quote again from that source:

> . . . trade unionism has tended to produce the following consequences on the economic position of the Negro in the American economy: 1) to reduce his access to many of the industries and trades in which trade unionism is an important factor (and particularly in the high-pay, skilled trades) through outright discrimination against non-whites; 2) to reduce the opportunities for the Negro to move to the higher-paid skilled or supervisory positions, again through outright discrimination; and 3) to reduce generally the opportunities for

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the Negro to find employment in union-covered industries and trades through a) the raising of wage rates above what the market would have brought into being, and b) the insistence on equal pay for equal work. Admittedly, some Negroes have shared in the higher incomes associated with union pressures on employers; on balance, though, the Negro has probably been a significant "loser" from the growth and present strength of trade unionism in the American economy.[12]

The same point has been made by Sir Arthur Lewis, the Jamaican-born black economist (and socialist) now teaching at Princeton University, who has written recently, "The trade unions are the black man's greatest enemy in the United States."[13]

To summarize: some of the problems usually identified as afflicting the city relate to the high unemployment rates in the low productivity work groups in the city and to the difficulty of minority race group members moving into the higher paid, higher skill jobs. I have argued that both of these urban problems have arisen in part from coercive interventions in the labor-exchange process by agencies of government and by private groups granted semi-governmental privileges.

As Vic Fingerhut, once principal speech writer for Vice-President Hubert Humphrey has pointed out, one of the central economic functions of the American city over the decades has been as a locus of relatively low-cost labor supplies. This was reflected in the great variety of light manufacturing, service and labor-intensive industries that were to be found in the cities of this country.

As artificial restrictions have been imposed upon the labor market, the city has produced unhappy consequences for urban populations.

Welfare legislation, minimum wages, maximum work hours, and the like have minimized the economic function of the conglomerations of poor-but-willing people in our cities. Similarly, the goad of hunger has been mitigated by the rising level of welfare payments. In Newark a woman with three children lives very badly on welfare payments, but these nevertheless average somewhere around $300 to $350 per month. To live at the same level, a man with a wife and three children would have to make about $5,500 a year. For unskilled labor, that sort of money just isn't available.[14]

This factor also accounts in part for the high welfare costs of most cities today – and for the high living costs in urban areas. A city can function only as it uses a high

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ratio of service-oriented industries not called for in the countryside, and it is precisely such services that are made much more expensive as a result of wage interventions.

Some of the market interventions that damage urban dwellers deal not with city processes but with farm processes. Thus the whole of the American farm program, including milk marketing programs and the whole paraphernalia of price supports and output restriction, impinge unfavorably on the urban consumer. Its impact is particularly severe on the low income urban consumer because he spends a very large part of his income on food, fiber and alcohol – all derived in whole or in part from farm outputs.

In one market after another, in one interference with voluntary exchange after another, the state has added to the woes of urban America. The policy implications would seem to be obvious.

Rule No. 2: Property Rights and Control

Individuals and groups shall be permitted (have the right) to use properties legally under their control in any manner they choose, provided that in so doing no damage is inflicted upon the person and/or property of unwilling third parties.

This rule would seem to be a two-part rule. Part 1 deals with the bundle of rights known as "private property," while part 2 deals with the problem usually identified as "pollution" or "externalities" or "neighborhood effects." In fact they are two sides of the same coin. A's right to use his property as he sees fit cannot be used as a defense of an action of his which denies B *his* right to *his*, B's, property. The freedom of your fist ends at my nose; the freedom to use private property ends at the property line. Spillovers from A's actions that affect B's use of his property are a direct violation of the right of property.

It should be obvious to one and all that modern governments have sinned grievously in both aspects of this private property rule. They have themselves invaded the property of private citizens in a great variety of ways and they have not protected the property rights of the B's of this world from the unwanted intrusions of the A's.

In what ways have governments in cities (and elsewhere) invaded the property rights of its citizens? In many, many ways. An example would be the use of the weapon of eminent domain to confiscate private properties for use by the state or for use by other private persons or groups. Is a road to be

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built? Seize the property of the citizen, paying him a price for it that, had he been willing to accept, would have made the confiscation unnecessary. Is it decided that some collection of assets is unsightly and undesirable? Seize those assets, tear down the buildings, then make the land available to other private parties and at a price by definition lower than they would have had to pay in a truly voluntary exchange. This is known as urban renewal or city planning or what-have-you.

If you wish to understand the true consequences of such actions, read the Martin Anderson book, *The Federal Bulldozer*,[15] or the following pages from the Jane Jacobs book:

There is a wistful myth that if only we had enough money to spend – the figure is usually put at a hundred billion dollars – we could wipe out all our slums in ten years, reverse decay in the great, dull, gray belts that were yesterday's and day-before-yesterday's suburbs, anchor the wandering middle class and its wandering tax money, and perhaps even solve the traffic problem.

But look what we have built with the first several billions: Low-income projects that become worse centers of delinquency, vandalism and general social hopelessness than the slums they were supposed to replace. Middle-income housing projects which are truly marvels of dullness and regimentation, sealed against any buoyancy or vitality of city life. Luxury housing projects that mitigate their inanity, or try to, with a vapid vulgarity. Cultural centers that are unable to support a good bookstore. Civic centers that are avoided by everyone but bums, who have fewer choices of loitering place than others. Commercial centers that are lack-luster imitations of standardized suburban chain-store shopping. Promenades that go from no place to nowhere and have no promenaders. Expressways that eviscerate great cities. This is not the re-building of cities. This is the sacking of cities.

That such wonders may be accomplished, people who get marked with the planners' hex signs are pushed about, expropriated, and uprooted much as if they were the subjects of a conquering power. Thousands upon thousands of small businesses are destroyed, and their proprietors ruined, with hardly a gesture at compensation. Whole communities are torn apart and sown to the winds, with a reaping of cynicism, resentment and despair that must be heard and seen to be believed.[16]

Explicit Ownership, No Zoning

In the same way that it has itself violated B's property rights, the state has permitted, in one form or another, to one degree or another, the A's of the world to trespass on B's property through air pollution, noise, etc. It is not that laws have not existed dealing

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with such questions. Indeed, that most remarkable of the unplanned creations of Western man, the Common Law, included a long history of cases in which the courts had redressed B's grievances against the trespassing A's of the world. (See for example, an unpublished doctoral dissertation by my colleague at Wabash, Steven Schmutte.)[17]

In many cities the general welfare was thought to require that the A's (perhaps major employing firms in the area) be permitted to continue to trespass on the properties of the B's in the community, else they might leave and set up shop in another city.

Admittedly, once a firm has been permitted to pollute for many years, a kind of adverse possession problem arises, and equity may demand an appropriate time period for a remedy to be developed. Moreover, it is inefficient and inappropriate for the court to state precisely *what form* the remedy is to take. To the charge that this is going to "cost a great deal," I reply that the cost is already being assessed – but it is being assessed in part against innocent third parties. The cost should be borne by the users of the goods and services involved, not by unwilling recipients of smoke, irritants and noise.

I might add that the proper approach is not to prescribe certain activities (such as brickmaking) in certain areas, but to proscribe the externalities. If a firm can find a way to make bricks in the center of an affluent suburb in such a way as to produce no externalities, no damage to surrounding properties, and if this is what it believes to be the appropriate site for the activity, the state should not intervene – as it now does with its zoning laws. The city of Houston, Texas has demonstrated the practicability of a city operating without zoning laws. Such laws represent an unwarranted invasion of private property and are certain to be abused by the governments involved.

A substantial part of the problem of externalities relates to the choice of uses for "spaces" (such as the air, lakes and streams, oceans, etc.) to which no one has explicit ownership. The Tragedy of the Commons arose precisely because it *was* a commons and not the private property of any one person or group. Should a given pond of water be used for boating or for fishing or as a wild game preserve or as a focal point for home sites or as a source of a cooling agent for a generating plant? Permit private ownership of the lake and such questions are readily resolved by the simple process of competitive bidding.

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And if the people of the city, who want more electric power, outbid the fishermen, so be it. As such questions are now decided, a few hundred (upper-income?) fishermen and nature lovers may be able to secure the lake as a fishing reserve at no cost to themselves and to even persuade the state to provide the fish as well.

This has been a most hurried and oversimplified look at a difficult problem area. But the difficulty lies not in deciding the proper principles to apply; the difficulty lies in the details of working out the applications of the principle.

To summarize: Through sins of both commission and omission, governments at all levels have violated the principle of private property. Some of the serious problems of urban America seem to arise from precisely the fact that states have themselves invaded private property and have permitted one private citizen to invade the property of another, in the form of spillover effects. Again, the policy implications seem obvious.

Rule No. 3: Only Minimize Coercion

The coercive power of government shall not be permitted (has no right) to be used for any purpose other than that of minimizing coercion in human affairs, i.e. for any purpose other than that generally described in the phrase, "law and order."

Here again governments at all levels have been involved in sins of commission and omission. They have undertaken a whole host of activities that have nothing to do with minimizing coercion and at the same time they have done a rather poor job in this country of maintaining "law and order."

Governments are involved in owning and operating schools, hospitals, utilities, housing projects, parks, golf courses, airports – but the list is almost limitless. In addition they subsidize, regulate, supervise and harass private owners and operators of enterprises.

It is my firm conviction that it can be demonstrated that these departures from right principle have produced unwanted rather than wanted outcomes. I believe it can be demonstrated that many of what are said to be the great problem areas of urban America – housing, transportation, school systems, tax burdens, and so forth – are directly traceable to overextension of government's role in human affairs.

I would find it interesting and useful to take but one of these areas – say, hospitals or schools – and attempt to prove my point. In fact, I have done just this for higher education and have come to

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the conclusion that "tax-supported education tends to make of our schools and colleges a collection of non-students under the tutelage of non-teachers and the administration of the incompetent."[18] However, time will not permit any fuller exploration of this and related topics. Suffice it to say that it is precisely the areas where the state has stepped in that problems of quality, quantity and cost are most in evidence; those goods and services relatively untouched by the dead hand of the state are precisely the ones about which we need not be concerned.

This disease of overextended government seems to strike urban areas more severely than rural (although God knows it is not unknown in the latter). One of the more obvious consequences of this fact is the constantly rising tax burdens that must then be imposed on urban populations. This in turn prompts both private citizens and businesses to "escape" the city, thus reducing the tax base, increasing welfare costs, etc. which in turn calls for even higher tax rates, and so on. The great multiplication of governmental activities has taken both attention and funds from the one legitimate area for government action: law and order. City planners seem always to be better paid than city policemen.

Non-market Pricing of Services

We turn now to the consequences that flow from the fact that many of the services offered within and around the city are not priced in a market process.

One of the more dramatic examples is to be found in the transportation services in urban areas. Specific users may be charged nothing and or may pay a charge having little or nothing to do with costs of providing the facility. This distorts the decision-making of both those who use and those who provide the facilities involved.

Here is the way in which Dean Dick Netzer of New York University's School of Public Administration and chairman of the Inter-University Committee on Urban Economics, has described some typical cases:

> There have been a number of estimates of the full social costs involved in peak-hour use of high-capacity urban freeways to and from the CBD. One such estimate is that the costs commonly exceed 11 cents per vehicle-mile. Ordinarily, the only prices for specific trips on highways that motorists confront are the gasoline taxes they pay, amounting to no more than 1 cent per vehicle-mile. So the peak-hour motorist should really be paying a price for highway use which is ten (or more) times greater than the price he usually does pay, while the peak-hour transit rider's fare

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should rise by much smaller proportions.

For the latter, an extreme case – for example, the construction of a new subway line in New York City to relieve overcrowding – might require a three- or four-fold increase in the fare. For peak-hour motorists, the extreme cases are truly fantastic. For example, if peak-hour uses of the proposed third tube of the Queens-Midtown Tunnel in New York, required only for rush-hour traffic, had to pay its full costs, the indicated toll would be at least $5, compared to 25 cents at present.[19]

In describing the impact of such pricing practices on city characteristics, Netzer concludes as follows:

Thus, the highly dispersed form of residential development characteristic of most American urban areas, involving heavy auto use even for commuting to work is not necessarily independent of changeable transportation characteristics. If auto use were no longer faster, more comfortable, and cheaper, it is a fair bet that some consumers would choose other transport modes and some of these would alter their residential location choices as well.

In a longer, more complete demonstration, a wider range of rules and cases could be explained. For example, no study of the city should be thought complete that ignores the consequences that have come from the modern system of welfare. The appropriate rule of right principle would be one that speaks against any coerced transfer of assets from one person to another. The case would build upon the incredible problems that have come from the impact of state-welfare-availability in urban areas upon the social, political and economic faces of the city. But enough is enough. It is time to summarize.

Summary: Toward The Good City

I have argued that, given the subjective, individual nature of value, it is impossible *per se* for there to be created a single, objective, meaningful definition or description of the Good City. I have questioned whether it would be possible by any means whatsoever to construct such a city, even were it possible to define it in advance.

I have presented as my central thesis the idea that the Good City cannot be described or aimed at in terms of its own characteristics but only in terms of the rightness of the rules system within which it emerges. Again, right rules promote right outcomes; wrong rules promote wrong outcomes.

I have admitted (nay, insisted) that the exact nature of the outcomes that would flow from right rules cannot be predicted in ad-

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vance. I have insisted though that it is possible to identify kinds of generally admitted city ills that have been brought on by wrong rules. The greater part of the paper has consisted of case studies of this part of the argument.

Let me close with a summarizing example of what I am trying to say. This, too, is drawn from the book by Jane Jacobs, *The Death and Life of Great American Cities,* and it relates to the "grew-like-Topsy" evolution of a given section of the city of Boston.

Twenty years ago, when I first happened to see the North End, its buildings — town houses of different kinds and sizes converted to flats, and four- or five-story tenements built to house the flood of immigrants first from Ireland, then from Eastern Europe and finally from Sicily — were badly overcrowded, and the general effect was of a district taking a terrible physical beating and certainly desperately poor.

When I saw the North End again in 1959, I was amazed at the change. Dozens and dozens of buildings had been rehabilitated. Instead of mattresses against the windows there were Venetian blinds and glimpses of fresh paint. Many of the small, converted houses now had only one or two families in them instead of the old crowded three or four. Some of the families in the tenements (as I learned later, visiting inside) had uncrowded themselves by throwing two older apartments together, and had equipped these with bathrooms, new kitchens and the like. Mingled all among the buildings for living were an incredible number of splendid food stores, as well as such enterprises as upholstery making, metal working, carpentry, food processing. The streets were alive with children playing, people shopping, people strolling, people talking.

I could not imagine where the money had come from for the rehabilitation, because it is almost impossible today to get any appreciable mortage money in districts of American cities that are not either high-rent, or else imitations of suburbs. To find out, I went into a bar and restaurant and called a Boston planner I know.

"Why in the world are you down in the North End?" he said. "Money? Why, no money or work has gone into the North End. Nothing's going on down there. Eventually, yes, but not yet. That's a slum!"

"It doesn't look like a slum to me," I said.

"Why, that's the worst slum in the city. It has two hundred and seventy-five dwelling units to the net acre! I hate to admit we have anything like that in Boston but it's a fact."

"Do you have any other figures on it?" I asked.

"Yes, funny thing. It has among the lowest delinquency, disease, and infant mortality rates in the city. It also has the lowest ratio of rent to income in the city. Boy, are those people getting bargains. Let's see . . . the child population is just about average for the city, on the nose. The

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death rate is low, 8.8 per thousand, against the average city rate of 11.2. The TB death rate is very low, less than 1 per ten thousand, can't understand it, it's lower even than Brookline's. In the old days the North End used to be the city's worst spot for tuberculosis, but all that has changed. Well, they must be strong people. Of course, it's a terrible slum."

"You should have more slums like this," I said. "Don't tell me there are plans to wipe this out. You ought to be down here learning as much as you can from it."

"I know how you feel," he said. "I often go down there myself just to walk around the streets and feel that wonderful, cheerful street life. Say, what you ought to do, you ought to come back and go down in the summer if you think it's fun now. You'd be crazy about it in summer. But of course we have to rebuild it eventually. *We have got to get those people off the streets.*"[20]

I submit that the problem lies in the attitude expressed in that last sentence. The solution lies in a return to those principles of human conduct that are generally and universally valid, in fact, to the ancient principles of private property, limited government and individual freedom.

• FOOTNOTES •

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Step to the Rear, Please

GARY NORTH

RECENTLY, I had occasion to purchase a pair of four-drawer filing cabinets. In recent years, I have become a kind of maniacal newspaper clipper, having been influenced heavily by a lady who is perhaps the world's champion. I keep running out of filing space, so out I go in search of more files.

I also have a phobia about buying anything new. I am always getting a bargain by picking up some used item on its last legs. Naturally, I spend most of my time (or rather my wife's time) poring over the classified ads in search of used filing cabinets. Unfortunately, there appear to be a lot of other people in southern California who are as frantic to buy them as I am. They are really quite scarce, and good ones bring $65 or more. Thus, when my wife spotted a pair for $15 each, she called immediately. We had not been the first ones to call, either, although the ritual over the classified ads begins early in the morning in our home. The lady was about to leave, but she planned to be back at one p.m. I decided to arrive early, since another person was coming to look at them.

Predictably, I was detained, so I arrived at one o'clock sharp. Sure enough, the other person was already there. He was in her garage, waiting for her to come out. When she appeared, he announced that he wanted the two filing cabinets and the separate metal card file on top. "He was here first," she said, half ashamed.

I had not even gotten close enough to examine the cabinets, but I had already made up my mind that I would pay $40 each. There is a psychological ploy that sometimes works at an auction: you let the bidding stabilize at one price, allowing some competitor to imagine that the item is virtually his. Then you shout out a bid considerably higher than his. Some-

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times it paralyzes the others into silence. You get the item, even though in a closer bid, the competition might have fought the price up even higher. (I'm told that some poker players use the opposite approach: nickel and dime the competition, keeping them in the game, when you're holding aces.) I decided that I ought to use this tactic.

"But He Was Not First"

"I'll pay $40 each, cash on the line," I announced. The other fellow looked stunned. Not as stunned as the lady did, however, "But he got here first," she repeated, completely confused by what I was saying. I had had an inkling that this would be her response. When she had stated that the other fellow got there first, I could see that she was looking for an easy way out. She did not want to have to face one of us with a negative response. That old standby, "he got here first," seemed to her to be the best way out. I had reintroduced the problem of decision.

I waited for an answer. She literally could not give one. The other fellow lamely said, "I'll buy them at the original price." That failed to solve her problem. I stood around for perhaps two or three minutes, waiting for her to make up her mind. A tremendous debate was apparently running through her mind. She told me, "These cabinets have been in the garage for years. We didn't think they were worth that much." My razor-sharp mind, geared as it is to marginal utility curves and the intricacies of linear regression analysis, immediately came up with a technically precise response: "They're worth what you can get for them, lady."

That seemed to strike some kind of responsive chord in her mind. "I guess that's right," she said. Still, it was too large a task. The other fellow had arrived first, after all. "You'll have to wait a minute." She went into the house. I heard her talking on the phone. When she came out, she did not even look at the other potential buyer – too difficult, I imagine. She said I could have them.

The other man, who appeared to be about 20 years old, with hair over his shoulders, stalked off. He never even bothered to try to buy the card file, although I had expressed no interest in it. His unsuccessful competition in a free market had seemingly demoralized him. After all, he *had* been there first.

This leads me to the question of the hour: Why is the initial response of so many people to competitive situations a variation of "I got here first"? My wife had one reasonable answer. From the

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day we are first in school, we are told to line up. Instinctively, we know that being first is best. If we do not know it instinctively, then teachers instruct us in this bit of arcane knowledge so early that we are not able to remember a time when we did not believe that first in line is best.

We also learned that it is not polite to sneak into the line or shove someone out of line. If being in the front of the line is something to be desired, then the use of fraud or violence is illegitimate. Reasonable enough. But what about those of us – the vast majority, by definition – who show up too late to be first in line? What about those of us who value other things, such as staying in bed a little longer, more than we value being first in line, but who would nevertheless like to be right up there at the front? There ought to be some way of getting a shot at that front spot in a legitimate fashion.

Try the Market

There is, of course: buy your way in. Trade. My frog for your space. Children work out such arrangements, too. But the possibility for such bargaining is extremely limited: teachers do not approve of it. They use the line as a means of rewarding those whom they favor. They use it as a means of discipline. "Baxter, you go to the end of the line right now. We'll have no more of *that!*" So poor Baxter slinks to the rear, head down. He is learning what the world has in store for people who do not follow the rules. (Pity the girl in front of Baxter. Since he was unable to exchange his frog for a spot in front, he can still use it for something creative and/or amusing.)

Schools are not market institutions for children. In our era, they are not even market institutions for parents. So there is only one other way to administer discipline and preserve order: bureaucratically. Someone in authority runs the place like a boot camp. Fair enough; children are not adults. But when do the adults start learning alternative ways of allocating scarce resources?

Look at the Federal Communications Commission. It controls the frequencies used in broadcasting. It awards licenses to those who perform according to the proper standards – set, of course, by the FCC. They do not allow competitive bidding, either for the right to rent, lease, or permanently purchase the right to use the designated frequencies. And you know what rule they use? Return the use of the frequencies to those who now control them, unless there has been a violation of the

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rules. In short, *they got here first!* So the rest of us – the vast majority of all those who would like to view an alternate station, and who would pay another management to provide us with what we want – slink, as usual, to the end of the line. In a bureaucratic world, most of us are Baxters. (Most of us have known it since kindergarten, too.)

Post Office Lines

What the FCC does to the airwaves, the Civil Aeronautics Board does for the airlines. The Interstate Commerce Commission is doing about the same with truckers, railroads, and anyone who would like to ship his goods more cheaply. But the archetype for the whole bureaucratic system is (you guessed it) the United States Postal Service. (Service is to Postal Service as demilitarized was to the Demilitarized Zone in Vietnam.) "I'm sorry, this line just closed." "But lady, I've been waiting for 30 minutes." "I'm sorry; please step to the end of that line over there."

Wouldn't it be great to shout out: "I've got this package to mail. Will one of you guys shuffling around behind that pile of unmoving mail like to earn three bucks to take care of this for me?" But that would be crass. That would disrupt the smooth non-flow of mail. Besides, you were late, weren't you? You failed to do your shopping on time. Now that you've been naughty, you know what has to happen, don't you? You bet your triplicate forms, you do. Back to the end of the line. And if some crass individual tries to set up a rival organization that allows you to pit man against man (dog against dog) to serve your equally crass wants, well that person will be hit with so many fines that he will be at the end of all lines for the rest of his life. (The phrase "anti-monopoly legislation," when used in reference to the Postal Service, means just that: legislation against any firm that is against the monopoly.)

There is only one person at the front of any given line. There are many ways of getting there. You can get up earlier. You can bribe the man directing the line. You can pay off the person up front. Or, probably best of all, you can go to some other place where the lines are shorter, probably because the prices are higher. You can pay with money or pay with time. In a bureaucratic culture, the latter is the only *legal* way to get to the front. That is why socialist nations are visible from about 1,000 feet in the air: lots of lines. The Soviet businessmen who spend their lunch "hour" standing in lines or shopping, have no other

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choice. If you are not able to convert your income into goods, because of price controls and artificial shortages, then the key asset is time. This is what men steal. This is how they prefer to be paid. Time, in a bureaucratic society, is *the* money. Lost time is the coin of the realm. It subsidizes those in the society who are unproductive, and who therefore have very low alternative uses for their time. Time is not even taxed; leisure is not on the graduated income tax scale.

A culture that puts all of its emphasis on being first in line is a culture in which men will waste lots of valuable time to look around for lines to be first in. A culture that will not permit men to bid up monetary prices in a competitive market guarantees the wasting of time on an enormous scale.

Moment of Decision

I know where that lady went when she could not decide what to do. She went to phone her husband. As my wife remarked, after I had made the purchase and we were driving home: "I knew you had it made when she went into the house. She had to be phoning her husband to get his advice, and he was almost certain to tell her to sell to the highest bidder."

She let him make the decision. She could have taken the $80, pocketed $50, and given him the $30 (the newspaper's price). It never occurred to her. Or she could have given him the $80, and they could have had an evening out, or more meat on the table, or whatever. But so conditioned was she to the bureaucratic first principle – "he was here first" – that she was emotionally paralyzed. She literally could not decide by herself.

We need more auctions in America. We need to make people think in terms of auctions. We need the auction mentality to creep into areas of life that are considered too sacrosanct to allow crass materialism, i.e., competitive pricing, to direct their operations. We need to find mature people who understand that there are more ways of getting to the front of the line than getting up at 5 a.m. or bringing Miss Grundy an apple. If we fail to allow the auction mentality to have its day, not in court, but in areas outside of the courts and law enforcement, then we will be ruled by an army of Miss Grundys all the days of our lives. It will destroy the creativity of men. And Baxter's a big boy now. He no longer drops frogs down little girls' backs. He blows up power stations in Portland. I may never make it to the front of the line, but I sure don't want Baxter behind me.

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Land Speculators

BERNARD H. SIEGAN

MY TALE this month is about a much abused species: people who buy and sell land, the so-called land speculators. The moral of my story is that persons earning money in private industry usually serve necessary and useful roles in the economy.

This is hardly the popular conception of land speculators. At some zoning hearings I have attended, confessed burglars, bombers and safe-crackers would have received more sympathetic consideration. Yet, the speculators were there performing as socially useful a purpose as anyone else present.

Currently that species is much in need of good cheer, for its business is terrible. With construction at one of the lowest levels in recent years, the market in land is unusually poor. While quotes on land prices appear to be escalating, buyers are scarce, and if there is a serious need to sell, prices have to be shaved sharply.

Keeping the land means paying real estate taxes and, for many, exceedingly high interest rates on purchase loans, often 20 to 25 percent and more, even for those obtained in better days. Credit crunches make nonsense of the notion that land speculation invariably brings huge profits.

But then, no business venture is free of risk. All businessmen seek to buy low and sell high, and they do not always succeed. This is as true of the shoe store owner as of the farmer, banker and builder. It is indeed difficult to determine the line where investment ends and speculation begins.

Land speculators, however, are thought to be different. Supposedly they are wealthy gamblers who exert no labor or effort on the land, and their presence operates only to raise prices. These assumptions are wrong, as I shall explain.

First, there are many people of middle income, and probably some of lower income, who buy for resale vacant lots and acreage. They also invest in groups or buy stock in corporations that purchase land. Considered a hedge against inflation, many have preferred this form of investment to stocks, bonds and savings deposits.

Farmers and people who inherit

Copyright 1974 Bernard H. Siegan
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land automatically become land speculators as the prospect of development appears. Some surveys of speculators in other commodities have shown that housewives, retired persons and people in many occupations and professions are much involved in buying and selling futures.

Second, unlike those in other fields, speculators in land frequently act as middlemen, preparing it for sale to builders. They subdivide, rezone, clear title problems, install roads and utilities, each of which can be a lengthy and costly process. They buy large tracts and sell off smaller parcels.

Cities, towns and major developments have been created in this manner by speculators. Houston, Texas, for example, began as a land speculation in 1836 in a low-lying swamp area.

Builders do engage in the same activities, but it requires considerable capital and time seldom available to small and middle-sized concerns. Warehousing and processing land can be costly and burdensome to large builders as well. Consequently many, perhaps most, builders find it advantageous to pay the middleman's mark-up rather than buy raw land at a lower price.

Third, land speculators provide a price floor for developable land. They create much larger markets than would exist if only builders purchased land, allowing farmers and other owners greater opportunities to convert their properties into cash.

In times such as the present, speculators make up a substantial part of whatever urban land market exists and prevent the bottom dropping out. By the same token, in better times, their eagerness to unload at a profit serves to hold prices down. Moreover, in readying it for construction purposes, speculators expand the supply of land available for immediate use, reducing the price below what it would otherwise be.

Thus, speculators tend to keep prices from rising too high or falling too low. The higher prices they create at one end of the process are likely to be more than offset by lower ones they cause at the other end. They add stability to the market and reduce price fluctuations, thereby lowering the risks of land ownership.

If the reader still condemns the land speculator, he should consider the only alternative: more government intervention and control. That action would further curtail but, due to constitutional property rights, could not eliminate speculation. The result would be less competition and even greater profits for those speculators who remain in the market.

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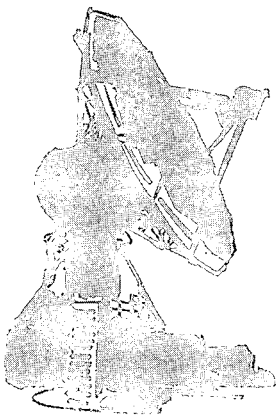
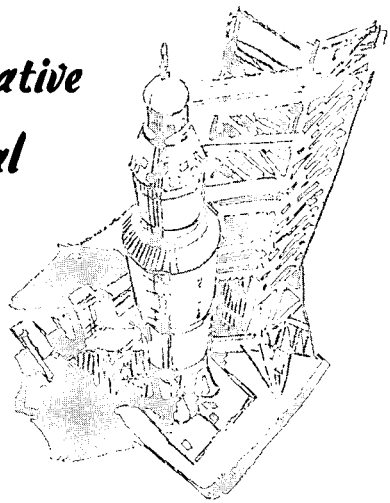


The Creative Ordeal



How little we know about the mainsprings of history. Most historical works make much of hero-politicians or the convergence of social forces. But a good case can be made that history turns on the activities of the inventor and the enterpriser, men who start things that deflect and modify the social currents and force the hero-politician to grapple with the unexpected and the unforeseen.

In World War II Winston Churchill, a hero-politician, stood up to Hitler, who had floated to power in a Germany that had been through the inflationary mill and couldn't find the means to pay for World War I reparations. But where would Churchill have been if certain "wizards" had not, in 1940, been able to equip some seven hundred Royal Air Force planes with a mysterious device called radar? It was radar that gave eyes to the air pilots on whom the West depended. It was, as Churchill himself acknowledged, the "war of the wizards." The Fascists were licked, not because they

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lacked wizards of their own, but because their theories of social organization, which stressed the collective rather than the individual, did not give full scope to the creativity of the "boffins," as the scientific innovators of the day were called.

Radar was a British invention, but it was an American company, little Raytheon of Massachusetts, that refined it and produced it in a volume that not only saved England but enabled the crippled U.S. Navy to stop the Japanese in the Pacific. And radar was only one example of the wizard contributions of Raytheon technicians. The war at sea could have been lost if it had not been for underseas detection devices provided by the same Yankee boffins. Eventually Raytheon moved into all sorts of homing devices that enabled missiles to strike airborne intruders without outside guidance, thus enabling the defense to catch up with the attack in the never-ending seesaw of war.

The story of the Raytheon company has been told in a beautifully inspiriting book, *The Creative Ordeal,* by Otto J. Scott (Atheneum, $12.95), that is even more the history of an era than it is of a single corporation. The indispensable company is probably as much of a myth as the indispensable man, but if the Raytheon story had not been what it was we would all be living in a vastly different world.

Research and Development

I confess that the nature of what goes on inside the mysterious tubes and semi-conductors and guidance systems that are the heart of the electronic revolution seems as ultimately unknowable to me as electricity itself. But men don't have to know what electricity is to use it, and electronics is more of the same. Furthermore, men don't have to know where they are going to start things; it is enough that they let their curiosity carry them along. Raytheon's predecessor company, the American Research and Development Corporation, hoped to make something by selling radio transmitters, but its prime asset at the start was Dr. Vannevar Bush of MIT, whose ideas about research and development ramified in several directions. Bush had a college roommate and partner, Laurence Marshall, who was a physics major in search of something more challenging than life in a classroom or a laboratory. Before Bush and Marshall and other men of AMRAD moved on to become Raytheon they tinkered with thermostatic discs and refrigerators, not realizing that the professorial C. G. Smith, their refrigerator in-

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ventor, had a better role in his mysterious thermionic tubes. Smith's new tubes were destined to push the radio industry into many unforeseen directions. But it was Laurence Marshall, the physics major turned entrepreneur, who became the soul of Raytheon.

The Demands of War —Space Flights and Kitchenware

Raytheon remained a mixed bag of interests, making welding machines, rectifier tubes, miniature components for hearing aids and what-not until war broke out in Europe in 1938. It was the war that brought Raytheon into its own. Whole navies had to be provided with radar eyes to protect themselves. The war in the air demanded radar tracking stations. When the buzz bombs began to descend on Britain, gun-laying radars developed by Raytheon were able to direct a barrage that destroyed ninety per cent of the bombs before they could land and do any damage. If the military had only known how to use the radar it already had in Hawaii in 1941, the Japanese attack on Pearl Harbor would have been a monumental fiasco. Young radar watchers followed the incoming Japanese planes on a screen for fateful miles and precious minutes, but they could not get anyone to take the blips seriously. The planes were thought to be American planes, even though they were coming from a strange quarter of the compass. Proving, no doubt, that the technological achievements of man often outrun the ability to make simple commonsense applications of the most marvelous devices.

After World War II there were other crises, even other wars. Raytheon's Lab 16 moved into the world of Sparrow and Hawk, missiles that could rise in the air and seek out low-flying enemy planes that had penetrated below the ordinary radar defenses. The moon shots provided further opportunity for Raytheon experimentation. And, on a more mundane level, Raytheon microwave ovens enabled restaurants and housewives to provide well-cooked meals almost in the blinking of an eye.

Woven into History

Otto Scott might have spoiled his story by drowning it in technical details. The narrative is incredibly crowded, but it is lightened and enlivened by its fusion with general history. The glittering Twenties give way to the tribulations of the Thirties, with New Deal Washington doing little or nothing to keep U.S. industry in a creative mood. But the industrial system kept working in spite of a politics that failed to comprehend

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its intimate needs. When the war came, the suppressed energies of the businessmen were fully equal to the task of backing up the military.

In Mr. Scott's story the men of Raytheon come clear even though some of their inventions seem virtually indescribable to those whose native language does not happen to be mathematics. The unknown heroes who provided the tools which known heroes such as Winston Churchill used to finish the job include Percy Spencer, an untutored genius whose 138 patents enabled little Raytheon to keep up with General Electric, Westinghouse and other giants of the industry. Laurence Marshall, Dr. Vannevar Bush's sidekick, carried Raytheon on his sturdy entrepreneur's shoulders until he became diverted by anthropological undertakings. His successor, Charles Francis Adams, Jr., a descendant of John and John Quincy Adams, brought a New England rectitude to the company that enabled it to survive the attempts of conglomerators to move it into channels that would have made it a stock market liability when times turned bad.

Through it all, the men of Raytheon continued to be patriots even more than they were scientists and businessmen. Part of a military-industrial complex, they were not in it for the money, although the money happened to be a useful by-product of sound sense. If the U.S. ceases to breed such dedicated men, it will surely succumb in a future that is certain to see laser weapons supplanting the atomic missile. It took the wizards to win World War II, and if our wizardry falters, we will lose World War III before it ever comes down to the first battle.

▸ CONFESSIONS OF A PRICE CONTROLLER by C. Jackson Grayson, Jr., with Louis Neeb (Homewood, Ill.: Dow Jones-Irwin, Inc., 1974) 265 pp., $9.95.

Reviewed by Melvin D. Barger

BACK in mid-October, 1971, C. Jackson Grayson, Jr., was surprised to receive an urgent call from Washington offering him the post of Chairman of the Price Commission. The Phase I price freeze was ending in a few weeks, and the Nixon Administration was now moving down the rocky road towards the country's first peacetime experiment with formal price controls. As Grayson remembers it, the offer – which he refused at first – was a "chance that will never come again."

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Confessions of a Price Controller is a highly readable, interesting account of what happened after Jack Grayson left his job as Dean of the Southern Methodist University business administration school and went to Washington to fix the nation's prices. The book is a valuable addition to the literature of free market economics because it shows how and why things go wrong when Government sets out to stabilize prices. Like many business-school professionals, Grayson is a believer in the free market who is willing to accept some government intervention for pragmatic reasons. But one does get the impression that Grayson's 15 months as a price controller had the effect of transforming him into a more outspoken advocate of the free marketplace, because he has since warned repeatedly against a reinstatement of price controls in any form.

Grayson's arguments will not sway those who insist on rigid price and wage controls. In this camp, it is a rule of faith that price controls can be administered effectively only by persons who believe in them. Grayson obviously looked on his Phase II mission as a temporary venture that should be phased out as soon as possible. A true believer in price controls would have regarded the moderate Phase II program as the launching pad for permanent and extensive controls.

For a nonbeliever, Grayson carried out his assignment heroically and honestly. Starting from scratch, he put together an organization and developed a basic program in only 16 days. At the very outset, however, the Price Commission became engulfed in the practical problems of price controls. There was the thorny problem of establishing a "base" period for the prices of each industry; as it turned out, there was almost no way to do this in an equitable manner for each company. There was the problem of deciding which companies should be under prenotification, reporting and surveillance. The decision to require prenotification for firms of $100 million or more in annual sales, rather than only those above the $250 million level, tripled the Price Commission's workload. There was also the problem of deciding which wage increases would be allowed to "pass through" as costs in price increases.

The Phase II Price Commission functioned with a staff of about 600, a lean organization for the complex task of "stabilizing" prices at predetermined levels throughout the U.S. economy. Grayson admits that Phase II controls relied heavily on "voluntary

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compliance," and he goes on to point out that a rigid, highly enforceable price control program would have required a staff of a hundred thousand people or more. As each price boost prenotification came to the Commission's attention, it always proved to have specific problems that were characteristic of a single company or a particular industry. Dow Chemical, for example, was granted a flat two per cent increase across its entire product line when the Commission was informed that as many as one hundred thousand applications might be needed to cover every Dow product. Costs soared in the construction industry, and pricing problems developed in petroleum, zinc, sugar, silver, wheat, fish, poultry, and cement. There was a reasonable attempt to make pricing exceptions to avoid hardship for various industries, but each exception, of course, helped give rise to the demand for others.

Grayson also gives the impression that the Commission and staff members were often divided or confused on key policy matters, and sometimes changed course as a matter of political expediency. In a very revealing comment, he explains that economic policy making in Washington "is a compromise – and often a heated one – of various points of view, many times with a paucity of data, gun slinging, interpersonal bickering, and widely differing recommendations . . . I had assumed – and I think it's true of the average citizen – that wise, gray-headed economic elders, assembled around a polished mahogany table, would lead the way to truth via factual logic and calm discussion . . . Of course it doesn't happen that way."

The way it did happen was that price control regulations were becoming more of a sieve than a barrier by the end of 1972, and both the public and the Administration were ready for the end of Phase II in January, 1973. Grayson helped preside over the liquidation of his own position, and one cannot help feeling that the timing for his departure was excellent. By mid-1973, prices were beginning to snowball, although the Administration still talked hopefully through Phases III and IV.

It was probably no chance thing that Grayson got out just in time. A man with excellent political instincts, he can sense when a movement or an idea has run its course. Price control wasn't working, and it is doubtful that the Price Commission could have retained more than a shred of its credibility into 1973. Grayson undoubtedly realized this, and the demise of Phase

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II also left him free to speak out against price controls and to point out the contradictions in any price control system.

In the closing pages of his book, Grayson makes a good defense of the free market system. He also admitted, shortly before closing out the Commission, that "Even with its imperfections, the marketplace is still better than we are." Like Dr. Ben Rogge, of Wabash College, he also harks back to Joseph A. Schumpeter's warnings about the threats of price control and other measures to the private enterprise system.

The major shortcoming of Grayson's book is in his failure to indict government's arbitrary expansion of the money supply and credit as the cause of inflation. He admits that "stimulating demand to achieve low unemployment risks inflation." He would have performed a valuable service by explaining what "stimulating demand" really means and how this basically Keynesian approach has steadily eroded the American dollar.

Despite this flaw, Grayson has given an honest portrayal of his 15 months as Chairman of the Price Commission. Now that inflation has reached double-digit rates, there will be renewed attempts to resort to self-defeating and contradictory price control measures. We may someday find ourselves under a price control system managed by a person who really believes in controls. But at least Grayson has given some convincing reasons for being a nonbeliever.

Editor's Note: When the same mail brings reviews of the same book, and when the subject is as urgent as the matter of price controls, it seems appropriate to share both reviews. The one which follows is by Dr. Hans F. Sennholz.

C. JACKSON GRAYSON's and Louis Neeb's *Confessions of A Price Controller* is a remarkably honest report on the way price controls were created and operated in the Nixon Phase II. Their honesty, which shines through their many admissions of price control chaos, the influence of power, pressure and politics, and finally, their repentance of it all, makes it a redemptive book that affords new hope to the reader. They became honest men which, you may be sure, left two rascals less in Washington.

The book sheds some light on the economic rationale that led the Nixon Administration to the price control system. It was expressed

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by Paul McCracken and Herb Stein of the Council of Economic Advisors in their first meeting with newly appointed Chairman Grayson: "Not much in classical economics seems to be working, why don't you come up with something on your own rather than be prejudiced by our views." (p. 7)

Surely it is difficult to fathom the reasoning of Nixon lieutenants. But it is incredible that they should have believed sincerely that they were conducting classical economic policies. They were running the biggest budgetary deficits in peacetime history, at double the Johnson rates during the Vietnam War, and were inflating the money supply at two-digit rates, and then conclude – without even blushing or suffering a stroke – that "not much in classical economics seems to be working."

The truth is that classical economists, yea even Mercantile and Medieval economists, have explained the consequences of such wild spending and inflating rather well. Goods prices must rise and the purchasing power of the monetary unit must fall. Classical economists, such as Smith and Ricardo, even explained the consequences of government price controls, the inevitable shortages and the ensuing economic disintegration. Could it be that the professors of economics serving on the Nixon Council of Economic Advisors had forgotten their classical economics? Or were they motivated by personal or political considerations?

They obviously confused their Keynesian economic recipes which they were following faithfully with "classical economics." If they would have had the courage to admit openly to the world that Keynesian policies had failed conclusively, they would be long remembered for honesty and courage. But instead, they preferred to hold on to the discredited recipes and to the confusion. What Haldeman and Ehrlichman did at Watergate, McCracken, Stein, and Shultz perpetrated in the economy.

Grayson's role in the price controls system was that of the master sergeant. He drilled the producers and merchants of peanut butter, applesauce, lumber, frozen foods, and a million other commodities. He drilled them in the cities and in the country, from coast to coast, millions of Americans of all ages. And like most sergeants he gave them much noise and many words, but little argument and less sense. There is probably nothing absurd or ridiculous in economic life that has not at some time been said and done by him and the other price commissioners. His book is a cogent brief on the absurdities of price controls.

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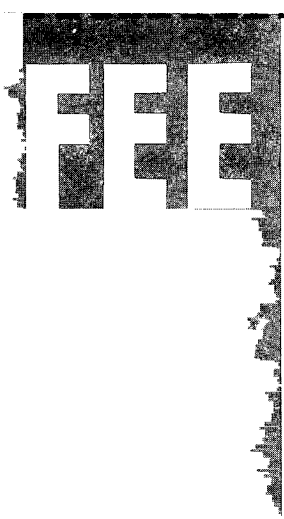

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